

COMMONWEALTH OF PUERTO RICO

Comprehensive Annual Financial Report

Fiscal Year Ended June 30, 2005

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2005



Commonwealth of Puerto Rico

Honorable Aníbal Acevedo Vilá
Governor

Prepared by:

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On the World Wide Web: <http://www.hacienda.gobierno.pr>*

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Year ended June 30, 2005

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INTRODUCTORY SECTION



Juan C. Méndez Torres, Esq., CPA
Secretary

March 30, 2006

To the Honorable Governor of Puerto Rico,
Members of the Legislature, and People of Puerto Rico:

It is a pleasure to submit, for your information, the Comprehensive Annual Financial Report (CAFR) of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the fiscal year ended June 30, 2005. This report, presented in three sections, Introductory, Financial, and Statistical, is the primary means of reporting the Commonwealth's financial activities.

The introductory section, which is not audited, includes this letter of transmittal, general information about the Commonwealth, a list of the Commonwealth's principal elected and appointed officials at the balance sheet date, an organizational chart, and a reproduction of the Certificate of Achievement for Excellence in Financial Reporting that the Commonwealth received for its June 30, 2004 CAFR. The financial section contains the independent auditors' report, management's discussion and analysis (MD&A), and the basic financial statements as listed in the table of contents. The financial section also includes the notes to the basic financial statements, required supplementary information, and other supplementary information. The statistical section, which is not audited, includes selected financial and demographic information, generally presented on a multi-year basis.

PROFILE OF THE COMMONWEALTH

The Puerto Rico Department of the Treasury is responsible for the preparation of this report. The responsibility for the accuracy of presented data and the completeness and fairness of the presentation, including all of the disclosures, rests on the Commonwealth's management. To the best of our knowledge and belief, the following data, as presented, is accurate in all material respects, and is presented in a manner designed to set forth the financial position and the results of operations of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth as of June 30, 2005 and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America. We have included all the necessary disclosures to enable the reader to gain a thorough understanding of the Commonwealth's activities.

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The financial reporting entity includes all funds of the Commonwealth, which comprises the primary government, as well as all its component units. In accordance with Governmental Accounting Standards Board's Statement No. 14, the Commonwealth's financial reporting entity includes 48 component units: 6 are blended component units including 3 fiduciary component units, 7 major discretely presented component units, and 35 nonmajor discretely presented component units. Component units are legally separate entities for which the primary government is financially accountable, or other organizations; the nature and significance of whose relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Discretely presented component units, both major and nonmajor, are reported in a separate column in the government-wide financial statements to emphasize that they are not part of the primary government and to differentiate their financial position and results of operations from those of the primary government.

Generally, each component unit issues audited financial statements, which can be obtained from the component unit's administrative offices. The basic financial statements included in the financial section of this CAFR provide descriptions of the operations of each of the following component units of the Commonwealth:

Blended Component Units:

Public Buildings Authority
Puerto Rico Maritime Shipping Authority
The Children's Trust

Discretely Presented Component Units:

Agricultural Services and Development Administration
Automobile Accident Compensation Administration
Cardiovascular Center Corporation of Puerto Rico and the Caribbean
Caribbean Basin Projects Financing Authority
Corporation for the Development of the Arts, Sciences, and Film Industry of Puerto Rico
Economic Development Bank for Puerto Rico
Employment and Training Enterprises Corporation
Farm Insurance Corporation of Puerto Rico
Fine Arts Center Corporation
Governing Board of the 9-1-1 Service
Government Development Bank for Puerto Rico
Institutional Trust of the National Guard of Puerto Rico
Musical Arts Corporation
National Parks Company of Puerto Rico
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives
Puerto Rico Aqueduct and Sewer Authority
Puerto Rico Conservatory of Music Corporation
Puerto Rico Convention Center District Authority

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Puerto Rico Council on Higher Education
Puerto Rico Electric Power Authority
Puerto Rico Government Investment Trust Fund
Puerto Rico Health Insurance Administration
Puerto Rico Highway and Transportation Authority
Puerto Rico Industrial Development Company
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities
Financing Authority
Puerto Rico Infrastructure Financing Authority
Puerto Rico Land Administration
Puerto Rico Land Authority
Puerto Rico Maritime Transportation Authority
Puerto Rico Medical Services Administration
Puerto Rico Metropolitan Bus Authority
Puerto Rico Municipal Finance Agency
Puerto Rico Ports Authority
Puerto Rico Public Broadcasting Corporation
Puerto Rico Solid Waste Authority
Puerto Rico Telephone Authority
Puerto Rico Trade and Export Company
Right to Employment Administration
Special Communities Perpetual Trust
State Insurance Fund Corporation
Tourism Company of Puerto Rico
University of Puerto Rico

Fiduciary Component Units:

Employees Retirement System of the Government of Puerto Rico and its Instrumentalities
Puerto Rico Judiciary Retirement System
Puerto Rico System of Annuities and Pensions for Teachers

Change in Administration

As a result of general elections, which took place in November 2004, a new administration took office in January 2005.

Independent Auditors

Commonwealth statutes require an annual audit by independent certified public accountants. The firm of KPMG LLP was selected by the Commonwealth to perform the audit of the basic financial statements in accordance with auditing standards generally accepted in the United States of America for the fiscal year 2004 – 2005. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Commonwealth for the fiscal year ended June 30, 2005 are free of material misstatements.



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The independent auditors' report on the basic financial statements is included in the financial section of this report.

Internal Controls

The management of the Commonwealth is responsible for establishing and maintaining internal controls to ensure that assets of the Commonwealth are protected from loss, theft, or misuse, and that adequate accounting data is compiled for the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

As a recipient of federal assistance, the Commonwealth is also responsible for ensuring that internal controls are in place to ensure that documents and processes are in compliance with applicable laws and regulations related to such federal financial assistance programs.

Certain departments, agencies, and political subdivisions are subject to the requirements of the U.S. Office of Management and Budget Circular A-133. As a result, these entities are audited for compliance with the requirements of the federal financial assistance programs. These audits are performed at the department or agency level. The Commonwealth has provided for the possible cost disallowance that may arise from these audits, as well as from other audits that may be performed by federal grantors.

Budget and Fiscal Policy

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the Central Government for the ensuing fiscal year.

The annual budget is prepared by the Puerto Rico Office of Management and Budget, working with the Puerto Rico Planning Board, the Puerto Rico Department of the Treasury, and other government offices and agencies. Section 7 of Article 6 of the Constitution provides that *"The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."*

The Commonwealth maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature. Activities of the general fund are included in the annual appropriated budget. Budgetary control resides at the department level. The Commonwealth also maintains an encumbrance accounting system as one method of maintaining budgetary control.

The annual budget, which is developed using elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under laws existing at the time the budget is submitted and legislative measures proposed by the Governor and submitted

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with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient and in conformity with the four-year investment plan prepared by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor, but may not increase items that would cause a deficit without imposing additional taxes to cover such deficit. Once approved by the Legislature, the budget is referred to the Governor, who may decrease or eliminate any item, but may not increase or insert new items in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, as originally approved by the Legislature and the Governor, it is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This allows the Commonwealth to continue to pay operating and other expenses until a new budget is approved.

Governmental Activities

General governmental activities of the Commonwealth are accounted for in four governmental funds. These funds are: general, special revenue, debt service, and capital project. The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Other major funds are the debt service fund, which accounts for the accumulation of resources predominantly for, and the payment of the Commonwealth general long-term bonds' principal, interest and related costs; the Public Buildings Authority capital project fund, which accounts for the financial resources used for the acquisition and construction of major capital facilities; and The Children's Trust special revenue fund, which accounts for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico. Nonmajor governmental funds are combined in a single column in the governmental fund financial statements, and individually identified in the supplementary combining nonmajor governmental funds financial statements of this report.

Business-Type Activities

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the government has decided that periodic determination of net income is appropriate for accountability purposes.

The Commonwealth's proprietary operations comprise the following activities: the Unemployment Insurance Trust Fund, the Lottery of Puerto Rico and the Additional Lottery System (the Lotteries Fund), both major funds. The Puerto Rico Water Pollution Control Revolving Fund, the Puerto Rico Safe Drinking Water



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Treatment Revolving Loan Fund, the Disability Insurance Fund, and the Drivers' Insurance Fund are all nonmajor proprietary funds combined in a single column in the proprietary fund financial statements, and individually identified in the supplementary combining nonmajor proprietary funds financial statements of this report.

Fiduciary Operations

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity or as an agent for individuals, private organizations, and other governmental units. These include the pension trust and agency funds. Pension trust funds are established through trust agreements specifying how the fund will operate. Agency funds are custodial in nature and do not report fund balances. The pension trust funds include the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities, the Puerto Rico Judiciary Retirement System, and the Puerto Rico System of Annuities and Pensions for Teachers.

Agency funds consist of the Special Deposits Fund. This agency fund includes deposits under the custody of the Courts of Justice for alimony payments, deposits under the custody of the Commissioner of Insurance of the Commonwealth for escheated property, and for insurance companies under bankruptcy.

Cash Management Policies and Practices

The Commonwealth maintains a cash pool for its cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing accounts in the Government Development Bank for Puerto Rico (GDB), a discretely presented component unit. In addition, the Puerto Rico Government Investment Trust Fund (PRGITF), was created by the Commonwealth pursuant to Act No. 176 of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust that was created for the purpose of providing eligible investors with a convenient and economical way to invest in a professionally managed money market portfolio. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

The Commonwealth's investment policy is to minimize credit and market risk while maintaining a competitive yield on its portfolio. The cash temporarily idle during this year was invested mainly in U.S. government securities, stocks, corporate bonds, repurchase agreements, Commonwealth securities, trading securities, and short-term investments. These are primary government investments that are restricted and unrestricted.

Capital Assets

These basic financial statements include the capital assets of the Commonwealth. A discussion of capital assets accounting is included in the MD&A that is part of the basic financial statements. More detailed information about capital assets can be found in the notes to the basic financial statements.

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Debt Administration

As of June 30, 2005, the Commonwealth had a number of debt issues outstanding. The Commonwealth has a BBB credit rating from Standard & Poor's Corporation and a Baa2 from Moody's Investor Service on general obligation bond issues, these classifications may vary in future years.

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued, which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on accounts of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of the Commonwealth Legislation and covered into Treasury of Puerto Rico in the two fiscal year preceding the current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. See the computation of the Legal Debt Margin on page 6 in the Statistical Section. More detailed information about long-term debt can be found in the notes to the basic financial statements.

Risk Financing

The Commonwealth purchases commercial insurance to cover casualty, theft, tort claims, and other losses. The current insurance policies have not been canceled or terminated. As it relates to worker's compensation, the Commonwealth's discretely presented component unit, the State Insurance Fund Corporation, provides workers' compensation to both public and private employees.

Financial Advisor and Fiscal Agent

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities, and public corporations, in connection with the issuance of bonds and notes, and to make loans to private enterprises to aid the economic development of Puerto Rico. GDB was the first governmental entity in Puerto Rico to obtain a Certificate of Achievement for Excellence in Financial Reporting for its CAFR. It has received the award for the years ended June 30, 1994 through 2004. GDB is presented as a major discretely presented component unit.

ECONOMIC CONDITIONS AND OUTLOOK

Puerto Rico enjoyed almost two decades of economic expansion through fiscal year 2001. Almost every sector of the economy participated, and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the value of the U.S. dollar, which is the currency used in the Commonwealth, increases in the level of federal transfers, a significant expansion in construction investment driven by infrastructure projects and private investment, primarily in housing, and the relatively low cost of borrowing.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. The economy of Puerto Rico is closely linked to the United States economy. The following exogenous variables are affected by the United States economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures.



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Manufacturing is the largest sector in terms of gross domestic product. Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor.

The services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism, and other services has shown a strong interaction with manufacturing, tourism, construction, and agriculture.

Tourism makes a significant contribution to economic activity. An estimated \$3,245 million were spent by visitors in Puerto Rico during fiscal year 2005. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. During the year 2005, the number of persons registered in tourist hotels increased 4.63% in comparison with fiscal year 2004. The construction sector is an integral part of the economic activity from fiscal year 1999 through fiscal year 2005. Puerto Rico is heavily dependent on oil imports for the production of electricity; however, as a result of the construction of two cogeneration plants, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99% to 72%.

The Puerto Rico Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2005 indicate that the economy registered an increase of 6% in total gross product. Gross product in fiscal year 2000 was \$41.4 billion and gross product in fiscal year 2005 was \$53.3. This represents an increase in gross product of 28.74% from fiscal year 2000 to fiscal year 2005.

In terms of personal income, in fiscal year 2005, personal income per capita was \$12,549 compared to 12,031 in 2004 and \$10,204 in 2000.

According to the Department of Labor and Human Resources, during fiscal year 2005 the labor force was 1.39 million compared to 1.36 million in fiscal year 2004. Unemployment, although at relative low historical levels, remains above the United States average. The average unemployment rate decreased from 11.4% during fiscal year 2004 to 10.6% in fiscal year 2005.

Major Initiatives

Individual Income Taxes

Resident individuals are subject to tax on their taxable income from all sources. As a result of legislation enacted in 1999 and 2000, there are several changes in income tax brackets applicable to future taxable years. However, due to significant limitation of available resources, the Commonwealth has deferred further reduction in income tax rates through fiscal year 2005, in an effort to maintain revenue levels, and avoid budgetary shortfalls. The Commonwealth is currently working on a fiscal and tax reform and expects to implement it during fiscal year 2006.

Industrial Incentives Program

Sections 30A and 936 of the U.S. Internal Revenue Code

For many years, U.S. companies operating in Puerto Rico enjoyed a special tax credit that was available under Section 936 of the U.S. Internal Revenue Code. Originally, the credit provided an effective 100% federal

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income tax exemption for most operating income, as well as qualifying investment income from Puerto Rico sources. Amendments to Section 936 made in 1993 (the 1993 Amendments) instituted certain methods for calculating the tax credit and limited the amount of the credit that a qualifying company can claim. As a result of amendments incorporated in the Small Business Job Protection Act of 1996 (the 1996 Amendments), the tax credit is now being phased-out over a 10-year period for existing 936 credit claimants and is no longer available for corporations that established operations in Puerto Rico after October 13, 1995 (including existing 936 corporations, if they establish new product lines in Puerto Rico). The 1996 Amendments also moved the credit based on the economic activity limitation to Section 30A of the Code and phased it out over 10 years. In addition, the 1996 Amendments eliminated the credit previously available for income derived from certain qualified investments in Puerto Rico.

Because of the credit limitations and impending phase-out of Sections 30A and 936, a large number of entities previously operating under the provisions of those sections have restructured their operations in Puerto Rico, in whole or in part, to become controlled foreign corporations (CFC). The Puerto Rico Office of Tax Exemption has received notification of over 60 corporations that have converted part or all of their operations under Puerto Rico tax incentives laws to CFCs. These include most major pharmaceutical, instrument, and electronics manufacturing companies in Puerto Rico. CFCs operate under transfer pricing rules for intangible income that are different from those corporations operating under Sections 30A and 936. In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operations, but must make a royalty payment "commensurate with income" to their U.S. affiliates. Section 936 companies were exempted from Puerto Rico withholding taxes on any cost-sharing payments they might have opted to make, but CFCs are subject to a 10% Puerto Rico withholding tax on royalty payments.

Proposed New U.S. Tax Regime for Companies Doing Business in Puerto Rico

In order to enhance the attractiveness for U.S. companies of establishing operations in Puerto Rico, the Commonwealth has been seeking to provide for a new and permanent tax regime applicable to U.S.-based businesses that have operations in the Commonwealth or other U.S. possessions. During the past three years, the Commonwealth has been pursuing an amendment to Section 956 of the U.S. Internal Revenue Code of 1986, as amended (the Code), that would establish a regime based on the tax rules generally applied to U.S. companies with international operations, but with certain modifications intended to promote employment both in the Commonwealth and the United States. The U.S. Congress, however, has not acted upon the proposed amendment to Section 956 of the Code. Also, due to the phase-out of Sections 30A and 936 of the Code, the U.S. Senate designated a special commission through the General Accounting Office to study the economic impact of said phase-out and to present recommendations on alternative tax incentives for U.S.-based companies operating in Puerto Rico. In the meantime, most U.S.-based companies operating under Sections 30A and 936 of the Code have converted from U.S. corporations to Puerto Rico or foreign corporations, which has lessened the impact of the phase-out of those sections.

Public Sector Debt

Historically, the Commonwealth has maintained, as a matter of fiscal policy, a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During certain fiscal years, however, public sector debt increased at a greater rate than the rate of gross product primarily due to an increase in the amount of debt incurred to finance certain key infrastructure projects,



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which are important to the development of the economy and are expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt to enable Puerto Rico to benefit from the historically low levels of interest rates and realize debt service savings. During fiscal year 2005, public sector debt increased 10.63%.

Prospects for the Future

The Commonwealth is committed to research and pursue solutions to improve the Commonwealth's competitive economic performance and the quality of life for its citizens. The Governor of Puerto Rico has established three long-range priorities which he expressed in his March 2005 state of the Commonwealth message. Those priorities, named "El Triángulo del Éxito," are: (1) to provide a new economy that generates new employments providing its citizens with the best quality of life, (2) to provide a safe society (3) to establish an excellent educational system for the benefit of the children.

The Commonwealth's economic development program is based on the fundamental, interrelated changes in technology, demographics, and institutions, which are transforming the global economy. These changes provide the challenges and opportunities that encompass the economic development strategy.

The economic program is based on: (1) refocus the economy on biotechnology, telecommunications, technology information, and related sectors, and (2) "Apoyo al de aquí" to create new Puerto Rican enterprises, and (3) infrastructure economic planning.

Initiatives to achieve the economic development program objectives have begun in the following five areas: (1) legislation towards economic development through tax and fiscal reform; (2) consolidation and reductions of governmental entities; (3) refocused strategic projects towards excise taxes; (4) reduction on subsidies provided to governmental entities; and (5) refocused strategic projects related to the citizen's health.

The proposed tax reform will (a) replace the Commonwealth's current excise tax with the consumption and use tax, (b) include compensatory income tax credits in order to address any regressive effect the proposed consumption tax may have, (c) eliminate the marriage penalty, (d) establish an earned income tax credit, (e) increase the deduction for charitable contributions, (f) restructure the estate tax system, (g) provide incentives for investments in technological infrastructure and research and development activities, and (h) adopt additional measures to foster individual savings. Legislation with respect to the tax reform proposed by the Joint Resolution was introduced in the House of Representatives with a proposed effective date of July 1, 2006. Although the final structure of the tax reform, including the consumption tax, is under discussion, the Department of the Treasury expects that the tax reform will provide a net increase in the General Fund's annual revenues, after taking into consideration projected reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural imbalance.

The proposed fiscal reform includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of OMB, and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to two percent (2%) of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund

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will increase by an additional two percent (2%) of the then-current authorization for each fiscal year thereafter, up to a maximum of twenty percent (20%) of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees Retirement System of the government of Puerto Rico and its Instrumentalities (Employees Retirement System) and the Puerto Rico System of Annuities and Pensions for Teachers (the Teachers Retirement System). The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System based on proposed legislation which provides for increased employer and employee contributions and the issuance of up to \$2 billion of pension obligation bonds, which would be payable from the Commonwealth's general fund. The Employees Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits.

Financial Condition

The MD&A, which can be found immediately following the independent auditors' report, provides an overview of the Commonwealth's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, the MD&A focuses on the Commonwealth's major funds. Component units and fiduciary activities are excluded from the MD&A.

Estimated Fiscal Year 2006 Compared to Actual Fiscal Year 2005

It is projected that the general fund total revenue for fiscal year 2006 will be \$9,684 million, representing an increase of \$476 million, or 5.2%, from preliminary fiscal year 2005 revenue. The proposed budget package included several new revenue-raising measures sufficient to cover budgeted expenditures, most of which required legislative approval. However, the Legislative Assembly did not approve the budget proposed by the Governor.

As a result of the Governor's veto, and in accordance with the Commonwealth's Constitution, the budget for fiscal year 2005 (with certain adjustments) carried over and will continue in effect for fiscal year 2006 unless another budget for fiscal year 2006 is approved by the Legislative Assembly and the Governor. At this time, it is not anticipated that a new budget for fiscal year 2006 will be approved prior to the end of the fiscal year, although it is possible that other appropriations for special purposes may be approved from time to time.

Other Information

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a ***Certificate of Achievement for Excellence in Financial Reporting*** to the Commonwealth for its CAFR for the fiscal years ended from June 1996 through 2002 and 2004. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for the preparation of state and local government financial reports.



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In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. The CAFR must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements. A Certificate of Achievement is valid for a period of only one year.

We believe the Comprehensive Annual Financial Report of the Commonwealth of Puerto Rico as of and for the fiscal year ended June 30, 2005 continues to conform to GFOA standards and we are submitting it to the GFOA to determine its eligibility for a Certificate of Achievement for Excellence in Financial Reporting.

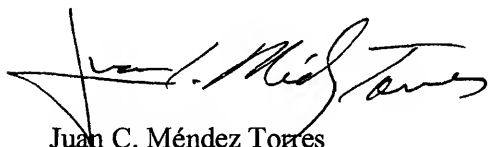
Acknowledgements

The preparation of this report requires the collective efforts of numerous finance personnel throughout the Commonwealth and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, and component units of the Commonwealth. We sincerely appreciate the dedicated efforts of all these individuals.

The report could not have been accomplished without the professionalism and dedication of Juan B. Torré Martínez, CPA, from our accounting team as well as the rest of the personnel of the Central Government Accounting area. Also, we would like to give special thanks to our independent auditors, KPMG LLP, for their advice and commitment.

This report continues our commitment to the citizens of the Commonwealth of Puerto Rico, the Governor, the Legislature, and the financial community, to maintain our general purpose financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Juan C. Méndez Torres". The signature is stylized with a large, sweeping initial "J" and a long, horizontal stroke extending to the right.

Juan C. Méndez Torres
Secretary of the Treasury

COMMONWEALTH OF PUERTO RICO

PRINCIPAL OFFICIALS

As of June 30, 2005

Aníbal Acevedo Vilá
Governor

Members of Cabinet

Aníbal José Torres
Chief of Staff

Fernando Bonilla
Secretary of State

Roberto Sánchez Ramos
Secretary of Justice

Juan C. Méndez Torres
Secretary of the Treasury

Rafael Aragunde
Secretary of Education

Román Velasco
Secretary of Labor and
Human Resources

Rosa Pérez Perdomo
Secretary of Health

José Orlando Fabré Laboy
Secretary of Agriculture

Gabriel Alcaraz
Secretary of Transportation and
Public Works

Jorge Silva Puras
Secretary of Economic
Development and Commerce

Yolanda Zayas Santana
Secretary of Family Affairs

Jorge Rivera Jiménez
Secretary of Housing

Javier Vélez Arocho
Secretary of Natural and
Environmental Resources

Alejandro García Padilla
Secretary of Consumer Affairs

David E. Bernier Rivera
Secretary of Sports and
Recreation

Miguel A. Pereira
Secretary of Corrections and
Rehabilitation

LEGISLATIVES OFFICERS

As of June 30, 2005

Kenneth McClintock Hernández
President, Senate

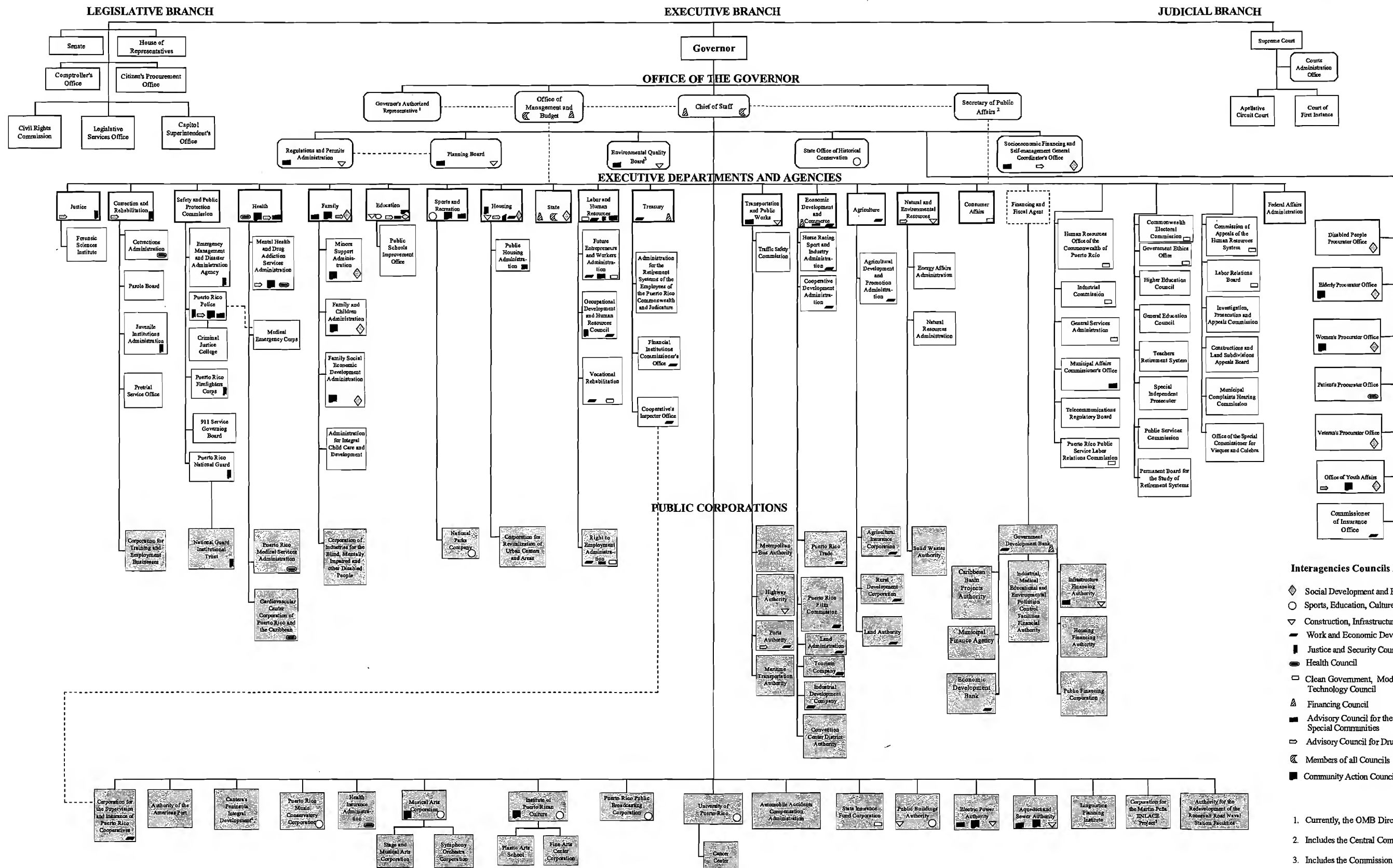
José Aponte
Speaker, House of
Representatives

FISCAL OFFICERS

As of June 30, 2005

Ileana Fas Pacheco
Director, Office of Management
and Budget

Alfredo Salazar
President, Government
Development Bank for
Puerto Rico



Interagencies Councils Members:

- ◆ Social Development and Family Council
- ◇ Sports, Education, Culture and Recreation Council
- ▽ Construction, Infrastructure and Housing Council
- ▬ Work and Economic Development Council
- Justice and Security Council
- Health Council
- Clean Government, Modern Management and Technology Council
- ⚙ Financing Council
- Advisory Council for the Development of Special Communities
- ⇒ Advisory Council for Drug Control in Puerto Rico
- ⌘ Members of all Councils
- Community Action Council

1. Currently, the OMB Director act as GAR.
2. Includes the Central Communications Office.
3. Includes the Commission for the Sustainable Development of Puerto Rico.
4. Valid until July 10, 2012, renewable for an additional 5 years or until the debts are cancelled.
5. Valid until September 24, 2024, renewable for an additional 5 years or until the debts are cancelled.

Certificate of Achievement for Excellence in Financial Reporting

Presented to
Commonwealth of Puerto Rico

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial
Reporting is presented by the Government Finance Officers
Association of the United States and Canada to
government units and public employee retirement
systems whose comprehensive annual financial
reports (CAFRs) achieve the highest
standards in government accounting
and financial reporting.



President

Executive Director

FINANCIAL SECTION



KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditor's Report

The Honorable Governor and Legislature of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2005, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Public Buildings Authority capital project fund (a major fund), which represents 4% and 1%, respectively, of the assets and revenue of the government activities. We also did not audit the financial statements of the following activities, funds, and component units:

- Puerto Rico Public Housing Administration, the Office for the Improvements of Public Schools, Human Resources and Occupational Development Council, and the Office for the Administration of the Assets of the Urban Renovation and Housing Corporation of the Commonwealth of Puerto Rico, which collectively represent 25% and 4%, respectively, of the assets and revenue of the general fund and 7% and 6%, respectively, of the assets and revenue of the governmental activities,
- The Additional Lottery System, which represents 58% and 38%, respectively, of the assets and revenue of the lotteries fund and 11% and 28%, respectively, of the assets and revenue of the business-type activities;
- Public Buildings Authority special revenue and debt service funds, which collectively represent 7% and 0%, respectively, of the assets and revenue of the aggregate remaining fund information and 3% and 0%, respectively, of the assets and revenue of the governmental activities;
- The pension trust funds, which represents 74% and 91%, respectively, of the assets and revenue of the aggregate remaining fund information; and
- Entities identified in note 2 that are presented as discretely presented component units, which collectively represent 98% and 97%, respectively, of the assets and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's

internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico as of June 30, 2005, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 6, the Commonwealth adopted GASB Statement No. 40, *Deposits and Investment Risk Disclosures* as of June 30, 2005.

The management's discussion and analysis on pages 3 through 21 and the schedule of funding progress on page 149 through 150 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The combining and individual fund financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These financial statements and combining schedules have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report listed in the table of content have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

March 14, 2006

Stamp No. 2102530 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Management of the Commonwealth of Puerto Rico (the Commonwealth) provides this Management's Discussion and Analysis for the readers of the Commonwealth's basic financial statements. This narrative overview and analysis of the financial activities of the Commonwealth is for the fiscal year ended June 30, 2005, and is intended to provide an easily readable explanation of the information provided in the attached basic financial statements. We encourage readers to consider this information with the Commonwealth's basic financial statements that follow.

FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT

Government-wide Highlights

- The Commonwealth reported a deficit of \$15.2 billion as of June 30, 2005, a deterioration in the financial position of \$3 billion from last year's balances. The accumulated deficit is principally the result of the Commonwealth's practice of issuing debt and transferring such funds to its discretely presented component units in order for them to carry out the corresponding construction programs.
- The Commonwealth's total deficit increased by \$3 billion (a 25% increase) as a result of this year's operations. The governmental activities deficit increased by \$2.9 billion (a 22% increase), while net assets of the business-type activities showed a decrease of \$181 thousand (a 21% decrease).
- The Commonwealth's governmental activities had total revenue of \$13.7 billion, which were exceeded by total expenses of \$17 billion, excluding transfers received from business-type activities amounting to \$493 million.
- The Commonwealth's business-type activities had total revenue of \$1.2 billion, which exceeded total expenses of \$930 million, excluding transfers made to the governmental activities amounting to \$493 million.

Fund Highlights

- As of June 30, 2005, the Commonwealth's governmental funds reported a combined ending fund balance (as restated) of \$386 million, a decrease of \$636 million in comparison with the prior year while the business-type activities decreased by \$181 million to reach \$671 million.
- The general fund reported a deficit of \$511 million as of June 30, 2005.
- The unemployment insurance trust fund reported net assets of \$503 million while the lotteries fund reported a deficit of \$201 million.

Long-Term Debt

- Total long-term obligations as of June 30, 2005 were \$25 billion, from which \$1.9 billion are due within one year. The long-term obligation of the governmental activities increased by \$2.1 billion (9%) to \$24.7 billion when compared to the prior year, while the business-type activities increased by \$12 million (3%) to \$407 million.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains additional required supplementary information in addition to the basic financial statements themselves. These components are described below:

Basic Financial Statements

The basic financial statements include two kinds of financial statements that present different views of the Commonwealth—the government-wide financial statements and the fund financial statements and combining major component units financial statements. These financial statements also include the notes to the basic financial statements that explain some of the information in the financial statements and provide more detail.

Government-wide Financial Statements

The government-wide financial statements provide a broad view of the Commonwealth's operations in a manner similar to a private sector business. The statements provide both short- and long-term information about the Commonwealth's financial position, which assists in assessing the Commonwealth's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenue and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

- ***Statement of Net Assets*** – This presents all of the government's assets and liabilities with the difference between the two reported as net assets (deficit). Over time, increases or decreases in the Commonwealth's net assets (deficit) may serve as a useful indicator of whether the financial position of the Commonwealth is improving or deteriorating.
- ***Statement of Activities*** – This presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event *giving* rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenue for each function of the Commonwealth.

Both of the above financial statements have separate sections for three different types of Commonwealth programs or activities. These three types of activities are as follows:

- ***Governmental Activities*** – The activities in this section are mostly supported by taxes and *intergovernmental* revenue (federal grants). Most services normally associated with Commonwealth government fall into this category, including general government, public safety, health, public housing and welfare, education, and economic development.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

- ***Business-Type Activities*** – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Commonwealth include the operations of the following major funds: unemployment insurance trust fund (administered by the Commonwealth Employment Security Bureau) and the lotteries.
- ***Component Units*** – These are organizations that are legally separate from the Commonwealth, but the Commonwealth is either financially accountable for them, or the nature and significance of their relationship with the Commonwealth is such that their exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The Commonwealth has both blended and discretely presented component units.
- ***Blended Component Units*** – Although legally separate entities, these are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes.

The Commonwealth's three blended component units are:

- Public Buildings Authority
 - Puerto Rico Maritime Shipping Authority
 - The Children's Trust
- ***Discretely Presented Component Units*** – These are operations for which the Commonwealth has financial accountability but they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Commonwealth's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue and expenses in relation to the total of all component units.

The Commonwealth's 43 discretely presented nonmajor component units are combined into a single column for reporting in the fund financial statements. Complete financial statements of the individual component units can be obtained from their respective administrative offices. Addresses and other additional information about the Commonwealth's component units are presented in note 1 to the basic financial statements.

The Commonwealth's seven discretely presented major component units are:

- Government Development Bank for Puerto Rico
- Puerto Rico Highway and Transportation Authority
- Puerto Rico Electric Power Authority
- Puerto Rico Aqueduct and Sewer Authority
- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Health Insurance Administration
- University of Puerto Rico

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

The government-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other states and local governments, uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual parts of the Commonwealth government, reporting the Commonwealth's operations in more detail than the government-wide financial statements. All of the funds of the Commonwealth can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are the following:

- ***Governmental Funds Financial Statements*** – Most of the basic services provided by the Commonwealth are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Commonwealth's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Commonwealth. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth has four major governmental funds. That is, each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenue, expenditures, and changes in fund balances. The Commonwealth's four major governmental funds are the general fund, The Children's Trust special revenue fund, the debt service fund, and the Public Buildings Authority capital projects fund. The remaining nonmajor governmental funds are grouped and presented in a single column in the governmental fund financial statements. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- ***Proprietary Funds Financial Statements*** – These funds are used to show activities that operate more like those of commercial enterprises. Because these funds charge fees for services provided to outside customers including local governments, they are known as enterprise funds. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Like

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

the government-wide financial statements, proprietary fund financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide financial statements for business-type activities and the proprietary fund financial statements. The Commonwealth has two major enterprise funds. As previously mentioned, they are the operations of the unemployment insurance trust fund (administered by the Commonwealth's Employment Security Bureau) and the lotteries. Other nonmajor proprietary funds are grouped and presented in a separate column in the enterprise fund financial statements. The basic proprietary funds financial statements can be found immediately following the governmental fund financial statements.

- ***Fiduciary Funds and Similar Component Units Financial Statements*** – These funds are used to account for resources held for the benefit of parties outside the Commonwealth government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the Commonwealth's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. They use the accrual basis of accounting. The Commonwealth's fiduciary funds are the pension trust funds (three separate retirement systems for employees, which are fiduciary component units of the Commonwealth), and the agency funds (which account for the assets held for distribution by the Commonwealth as an agent for other governmental units, other organizations, or individuals). The basic fiduciary funds and similar component units' financial statements can be found immediately following the proprietary fund financial statements.

Component Units Financial Statements

As mentioned above, these are operations for which the Commonwealth has financial accountability but they have certain independent qualities as well, and they operate similar to private-sector businesses. The government-wide financial statements present information for the component units in a single column of the statement of net assets. Also, some information on the statement of changes in net assets is aggregated for component units. The combining statements of net assets and the combining statement of activities provide detail for each major component unit and the nonmajor component units in aggregate. The basic combining financial statements for major component units can be found immediately following the fiduciary funds financial statements.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the financial statements can be found immediately following component units' financial statements.

Required Supplementary Information

The basic financial statements include within its notes a section of required supplementary information. This section includes information of funding progress for the Commonwealth's three separate retirement systems.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. Total assets and total liabilities of the Commonwealth's primary government at June 30, 2005 amounted to \$13.3 billion and \$28.6 billion, respectively, for a net deficit of \$15.2 billion, compared to \$12.1 billion net deficit at the beginning of the current year, as restated.

A portion of the Commonwealth's net assets (deficit) reflects its investment in capital assets such as land, buildings, equipment and infrastructure, less any related debt used to acquire those assets that are still outstanding. The Commonwealth uses these capital assets to provide services to its residents; consequentially, these assets are not available for future spending. Although the Commonwealth's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Commonwealth's net assets (deficit) represents resources that are subject to external restrictions on how they may be used. An otherwise positive remaining balance would be used to meet the Commonwealth's ongoing obligations to its residents and creditors. Internally imposed designations of resources are not presented as restricted net assets. At the end of the current fiscal year, the Commonwealth is able to report positive balances in two categories of net assets, and a deficit, both for the government as a whole, as well as for its separate governmental and business-type activities.

As explained earlier, the net deficit of the primary government primarily results from the Commonwealth's practice of issuing debt and transferring such funds to the component units so that they can carry out the construction projects. The primary government retains the debt while the component units report the corresponding asset financed by such debt.

Total assets increased by \$375 million during the fiscal year 2005 when compared to prior fiscal year. The key elements for this increase are as follows:

- Restricted cash decreased by \$574 million when compared to the prior year. This decrease is primarily the result of a reduction in the unused proceeds from the facilities revenue bonds by the Public Buildings Authority and a reduction in the unused proceeds from the capital fund program bonds as a result of projects carried out during the year.
- Net increase in capital assets amounting \$1 billion.

Total liabilities increased \$2.8 billion during the current fiscal year when compared to the prior fiscal year. The key elements for this increase are mostly due to the net increase in debt issued of \$4.6 billion which consisted of issuances during fiscal year 2005 of Commonwealth general obligation bonds and notes payable amounting to \$642 million, and \$4 billion, respectively, offset by repayments of such debt in the amount of \$281 million and \$3.6 billion. Increases were also experienced in the net pension obligation of \$302 million and the liability for legal claims and judgments of \$722 million. The increase in legal claims is the effect of a legal case brought against the Commonwealth by parents of special education students as further explained in note 18 to the basic financial statements.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Commonwealth's Net Assets – Primary Government

June 30, 2005

(expressed in thousands)

	Governmental activities	Business-type activities	Total
Assets:			
Current assets	\$ 2,897,994	886,219	3,784,213
Capital assets	7,119,033	1,367	7,120,400
Other assets	2,187,383	222,748	2,410,131
Total assets	12,204,410	1,110,334	13,314,744
Liabilities:			
Current liabilities	5,268,743	142,818	5,411,561
Noncurrent liabilities	22,852,456	296,666	23,149,122
Total liabilities	28,121,199	439,484	28,560,683
Net assets (deficit):			
Invested in capital assets, net of related debt	3,623,158	847	3,624,005
Restricted	296,692	872,215	1,168,907
Unrestricted	(19,836,639)	(202,212)	(20,038,851)
Total net assets (deficit)	\$ (15,916,789)	670,850	(15,245,939)

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Commonwealth's Net Assets – Primary Government

June 30, 2004

(expressed in thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Assets:			
Current assets	\$ 2,989,468	884,062	3,873,530
Capital assets	6,099,129	1,672	6,100,801
Other assets	2,568,723	396,838	2,965,561
Total assets	<u>11,657,320</u>	<u>1,282,572</u>	<u>12,939,892</u>
Liabilities:			
Current liabilities	5,070,859	146,233	5,217,092
Noncurrent liabilities	20,242,807	284,510	20,527,317
Total liabilities	<u>25,313,666</u>	<u>430,743</u>	<u>25,744,409</u>
Net assets (deficit):			
Invested in capital assets, net of related debt	3,133,230	1,672	3,134,902
Restricted	—	853,194	853,194
Unrestricted	(16,789,576)	(3,037)	(16,792,613)
Total net assets (deficit)	<u>\$ (13,656,346)</u>	<u>851,829</u>	<u>(12,804,517)</u>

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Changes in Net Assets

The Commonwealth's net deficit increased by \$3 billion or 25% from last year's total net deficit. Approximately 57% of the Commonwealth's total revenue came from taxes, while 31% resulted from grants and contributions (primarily federal financial assistance). Charges for services represented 5% of the total revenue. The Commonwealth's expenses cover a range of services. The largest expenses were for education, public housing and welfare, and public safety. In 2005, governmental activities' expenses exceeded program revenue by \$12.1 billion, resulting in the use of \$9.2 billion in general revenue (mostly taxes) and transfers. On the other hand, program revenue from business-type activities in 2005 exceeded expenses by approximately \$280 million. In addition, the business-type activities had unrestricted investment earnings of \$32 million and transfers to the governmental activities amounting to \$493 million.

Governmental activities decreased the Commonwealth's net assets by \$2.9 billion, which is on line with the decrease of \$2.8 billion experienced in the prior year.

Business-type activities decreased the Commonwealth's net assets by \$181 million. The key factor of this variance was a transfer of funds of \$200 million from the Additional Lottery System to the general fund as further explained in note 10 to the basic financial statements.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government Year ended June 30, 2005 (expressed in thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Revenue:			
Program revenue:			
Charges for services	\$ 702,691	1,187,009	1,889,700
Operating grants and contributions	4,096,204	22,315	4,118,519
Capital grants and contributions	121,083	—	121,083
	<u>4,919,978</u>	<u>1,209,324</u>	<u>6,129,302</u>
General revenue:			
Income taxes	5,526,006	—	5,526,006
Property taxes	126,299	—	126,299
Excise taxes	2,101,216	—	2,101,216
Other taxes	7,128	—	7,128
Revenue from component units	474,069	—	474,069
Other	521,784	32,284	554,068
	<u>8,756,502</u>	<u>32,284</u>	<u>8,788,786</u>
Total revenue	<u>13,676,480</u>	<u>1,241,608</u>	<u>14,918,088</u>
Expenses:			
General government	1,827,816	—	1,827,816
Public safety	2,580,951	—	2,580,951
Health	2,364,110	—	2,364,110
Public housing and welfare	3,443,886	—	3,443,886
Education	5,000,686	—	5,000,686
Economic development	1,006,945	—	1,006,945
Intergovernmental	—	—	—
Interest and other	845,556	32,437	877,993
Lotteries	—	699,407	699,407
Unemployment	—	197,967	197,967
Total expenses	<u>17,069,950</u>	<u>929,811</u>	<u>17,999,761</u>
(Decrease) increase in net assets before transfers	(3,393,470)	311,797	(3,081,673)
Transfers	492,776	(492,776)	—
Decrease in net assets	<u>(2,900,694)</u>	<u>(180,979)</u>	<u>(3,081,673)</u>
Net assets (deficit), beginning of year	<u>(13,016,095)</u>	<u>851,829</u>	<u>(12,164,266)</u>
Net assets (deficit), end of year	<u>\$ (15,916,789)</u>	<u>670,850</u>	<u>(15,245,939)</u>

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government Year ended June 30, 2004 (expressed in thousands)

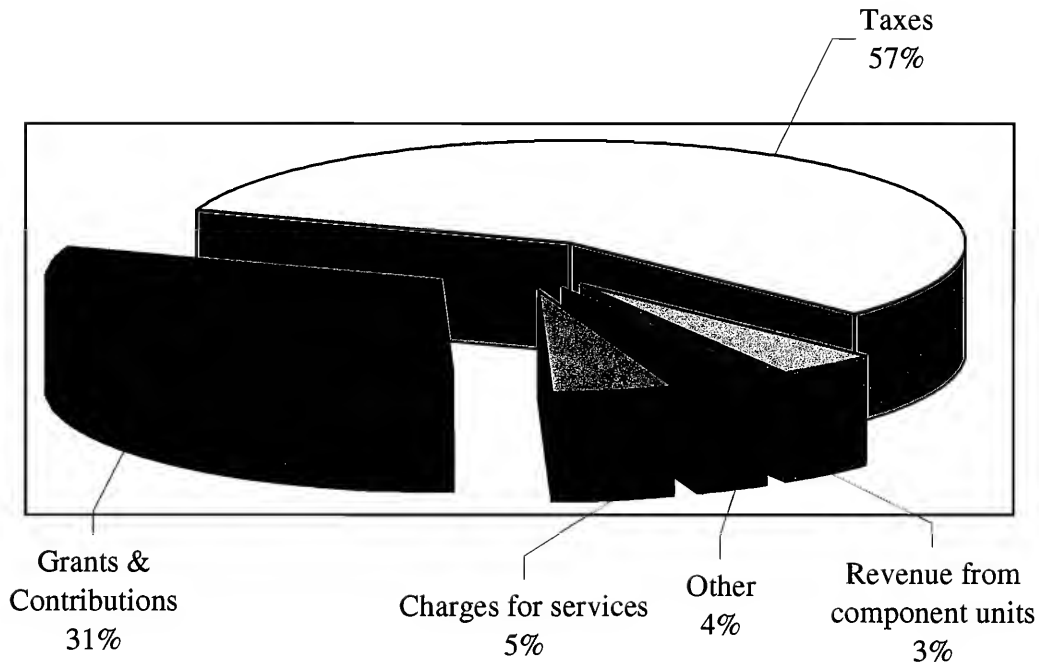
	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Revenue:			
Program revenue:			
Charges for services	\$ 769,207	1,136,705	1,905,912
Operating grants and contributions	3,462,924	59,728	3,522,652
Capital grants and contributions	167,907	—	167,907
	<u>4,400,038</u>	<u>1,196,433</u>	<u>5,596,471</u>
General revenue:			
Income taxes	5,191,080	—	5,191,080
Property taxes	121,815	—	121,815
Excise taxes	1,924,610	—	1,924,610
Other taxes	19,211	—	19,211
Revenue from component units	175,729	—	175,729
Other	399,615	23,831	423,446
	<u>7,832,060</u>	<u>23,831</u>	<u>7,855,891</u>
Total revenue	<u>12,232,098</u>	<u>1,220,264</u>	<u>13,452,362</u>
Expenses:			
General government	1,963,879	—	1,963,879
Public safety	1,950,635	—	1,950,635
Health	2,386,735	—	2,386,735
Public housing and welfare	2,919,315	—	2,919,315
Education	3,684,331	—	3,684,331
Economic development	896,925	—	896,925
Intergovernmental	591,237	—	591,237
Interest and other	778,700	26,763	805,463
Lotteries	—	731,344	731,344
Unemployment	—	142,652	142,652
Total expenses	<u>15,171,757</u>	<u>900,759</u>	<u>16,072,516</u>
(Decrease) increase in net assets before Transfers	(2,939,659) 203,258	319,505 (203,258)	(2,620,154) —
Special item – land and recreational facilities transferred to municipalities	<u>(35,646)</u>	<u>—</u>	<u>(35,646)</u>
Decrease in net assets	(2,772,047)	116,247	(2,655,800)
Net assets (deficit), beginning of year	(11,952,784)	735,582	(11,217,202)
Restatement to beginning net assets (deficit)	<u>1,068,485</u>	<u>—</u>	<u>1,068,485</u>
Net assets (deficit), end of year	<u>\$ (13,656,346)</u>	<u>851,829</u>	<u>(12,804,517)</u>

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Revenue – Governmental Activities Year ended June 30, 2005



Expenses – Governmental Activities Year ended June 30, 2005 (expressed in thousands)

Functions	Expenses
Primary Government:	
Governmental Activities:	
General Government	1,827,816
Public Safety	2,580,951
Health	2,364,110
Public Housing and Welfare	3,443,886
Education	5,000,686
Economic Development	1,006,945
Interest and other	845,556
Total Governmental Activities	<u>\$ 17,069,950</u>

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Governmental Activities

Governmental activities increased the Commonwealth's net deficit to \$15.9 billion. The decrease in net assets by the business-type activities is explained below. A comparison of the cost of services by function for the Commonwealth's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities (expressed in thousands).

Governmental Activities – Expenses Net of Program Revenue Year ended June 30, 2005 (expressed in thousands)

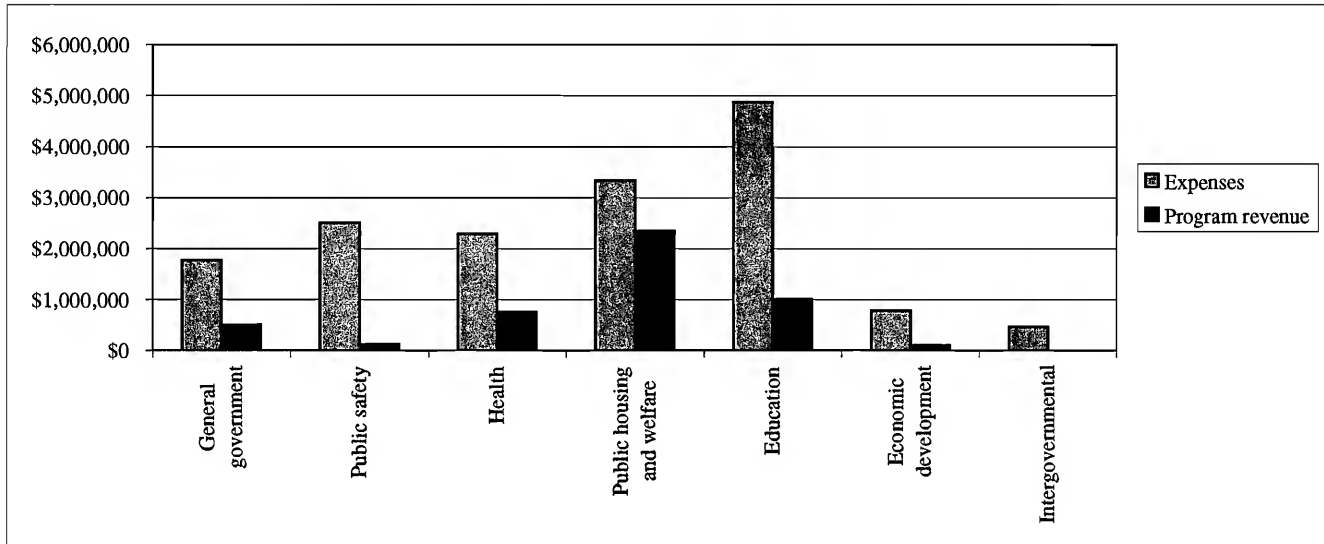
Net (Expense) Revenue:	
General government	\$ (1,319,906)
Public safety	(2,461,709)
Health	(1,612,738)
Public housing and welfare	(1,099,298)
Education	(3,901,621)
Economic development	(909,144)
Interest and other	<u>(845,556)</u>
Total governmental activities expenses', net program revenue	(12,149,972)
General revenue:	
Taxes	7,760,649
Revenue from component units	474,069
Transfers from business-type activities	492,776
Other revenue	<u>521,784</u>
Increase in governmental activities net deficit	\$ <u><u>(2,900,694)</u></u>

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Expenses and Program Revenue – Governmental Activities Year ended June 30, 2005 (expressed in thousands)



Business-Type Activities

The business-type activities decreased the Commonwealth's net assets by \$181 million. The decrease was primarily caused by a transfer of \$200 million made by the Additional Lottery System to the general fund as previously explained.

FINANCIAL ANALYSIS OF THE COMMONWEALTH'S INDIVIDUAL FUNDS

As noted earlier, the Commonwealth uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of fiscal year 2005, the Commonwealth's governmental funds reported combined ending fund balance, of \$386 million, a decrease of \$636 million or 62% in comparison with the prior year. The decrease in the governmental fund balance is due to increases in public safety, educational and health expenditures in the aggregate amount of approximately \$1.3 billion offset by an increase of \$1.6 billion in revenues and a decrease in the bond proceeds of \$1.4 billion (see Budgetary Highlights section). There is \$868 million of fund balance reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the prior fiscal year, or (2) for a variety of other restricted purposes.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

The general fund is the chief operating fund of the Commonwealth. At the end of the current fiscal year, unreserved fund deficit of the general fund was \$1.3 billion, while the total fund balance has a total deficit of \$511 million. The fund balance of the Commonwealth's general fund decreased by \$147 million as a result of the current fiscal year's change in financial position. This is a 40% increase when compared to total fund balance reported in fiscal year 2004. Also, see additional related comments in the following section titled General Fund Budgetary Highlights.

Proprietary Funds

The Commonwealth's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. As discussed in the business-type activities above, the Commonwealth's net assets decreased by \$181 million as a result of operations in the proprietary funds. This resulted from a \$201 million decrease (1465% from prior year) in net assets by the lotteries fund, a decrease in net assets of \$17 million by the unemployment insurance trust fund and an increase of net assets of \$36 million by the Commonwealth's other nonmajor enterprise funds.

GENERAL FUND BUDGETARY HIGHLIGHTS

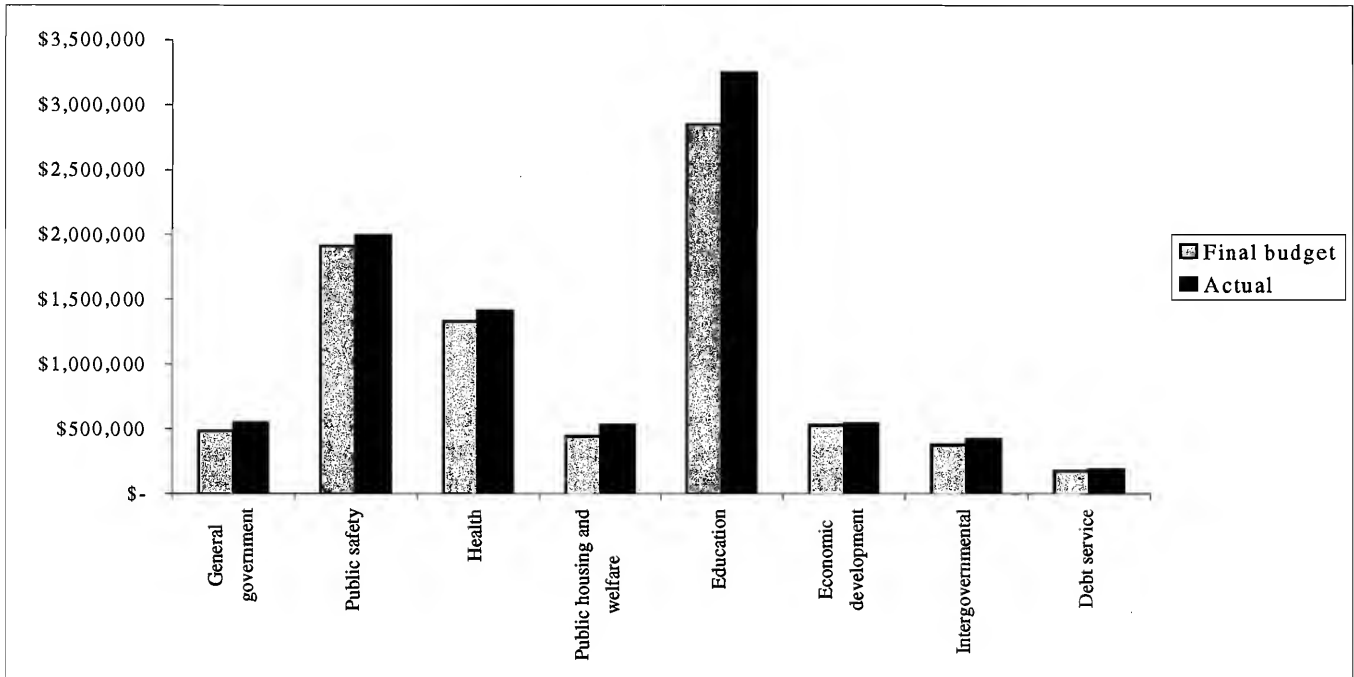
Actual revenues exceeded final budgeted revenue by \$442 million. The net increase was primarily attributed to unbudgeted revenue derived from component units, \$317 million from the Puerto Rico Infrastructure Financing Authority and \$30 million from the Puerto Rico Industrial, Tourist, Educational, Medical, Environmental Control Facilities Financing Authority. Also, the Commonwealth entered into debt service deposit agreements that provided revenue of \$82.7 million reported as other revenue. Other revenue also includes fines, penalties, registration fees and custom duties which experienced an increase of \$12 million during 2005. The actual expenditures reflected an increase of \$780 million when compared to the final budgeted amounts. The excess in expenditures was predominantly caused by the Department of Education with \$403 million, the Department of Health with \$56 million, the Department of Labor and Human Resources with \$42 million, the Mental Health and Drug Addiction Service Administration with \$25 million, the Corrections Administration with \$24 million, the Commonwealth Election Commission with \$22 million, and the Right to Employment Administration with \$21 million. Most of these variances were financed through the use of borrowings which provided resources of \$757 million. In addition the transfer from other funds exceeded the final budget by \$289 million primarily attributable to a transfer of \$200 million from lotteries fund.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Expenditures – General Fund Budget vs. Actual Year ended June 30, 2005 (expressed in thousands)



As of June 30, 2005, there was an excess of revenue and other financing sources over expenditures of other financing uses of \$75 million.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2005, amounts to \$9.5 billion, an accumulated depreciation of \$2.4 billion, leaving a book value of \$7.1 billion. This investment in capital assets includes land, buildings, building improvements, equipment, construction in progress and infrastructure.

The net book value of capital assets at June 30, 2005 is distributed by function/activity in the following proportions: general government, 41%; public safety, 5%; health, 1%; public housing and welfare, 33%; and education, 7%; and economic development 12%. Actual expenditures to purchase or construct capital assets were approximately \$666 million for the year. Depreciation charges for the year totaled \$211 million.

The infrastructure assets representing items that are normally immovable and of value only to the Commonwealth as roads, highways, bridges, toll facilities, water and sewer systems, lighting production, transmission and distribution systems, and similar items are principally owned by the component units of the Commonwealth. Therefore, these infrastructure assets are reported within depreciable capital assets under the

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

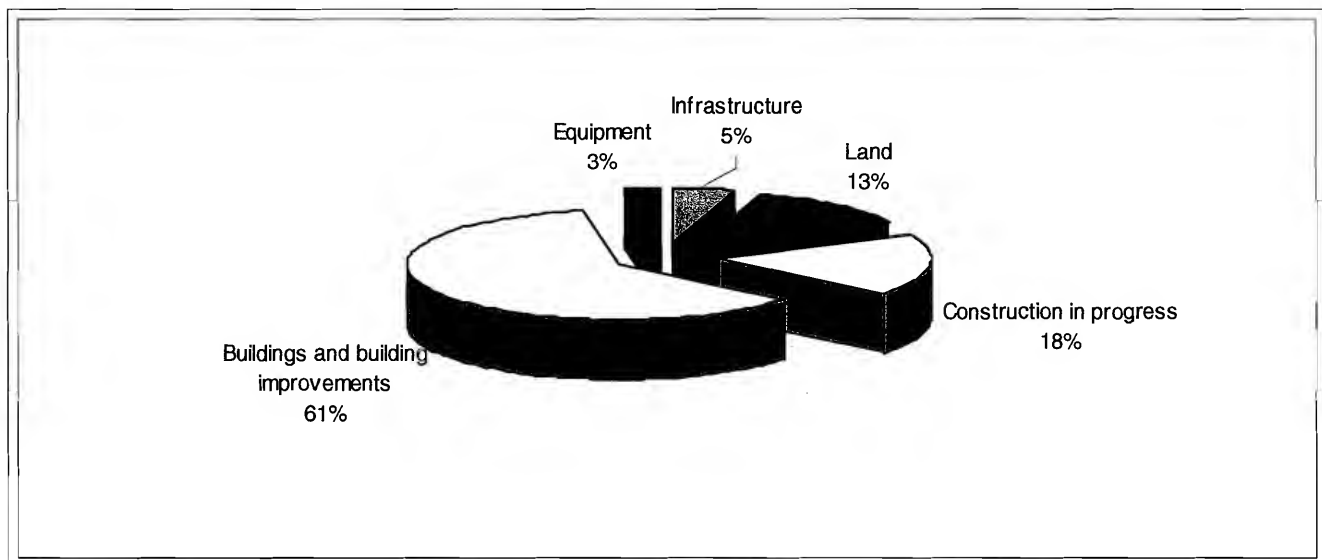
discretely presented component units' column. During 2005, the Commonwealth retroactively capitalized infrastructure assets amounting to \$638 million, net of accumulated depreciation. Approximately, \$296 million was recorded as construction in progress pending completion of the infrastructure projects. These general infrastructure assets include dams, intake facilities and similar items for flood control, water supply and recreational purposes. Additional information on the Commonwealth's capital assets can be found in note 12 to the basic financial statements that accompany this report.

Commonwealth's Capital Assets – Government

June 30, 2005

(expressed in thousands)

	Governmental activities	Business-type activities
Land	\$ 930,466	—
Construction in progress	1,271,616	—
Buildings and building improvements, net	4,382,264	—
Equipment, net	192,714	1,367
Infrastructure, net	341,973	—
Total capital assets	\$ 7,119,033	1,367



COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

Debt Administration

General obligation bonds are backed by the full faith and credit of the Commonwealth, including the Commonwealth's power to levy additional taxes to help ensure repayment of the debt.

The Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth, are not to be issued if the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution of the Commonwealth does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. At June 30, 2005, the Commonwealth is in compliance with the debt limitation requirement.

In 2005, Moody's lowered its rating on the Commonwealth's outstanding general obligation bonds from "Baa1" to "Baa2." Standard & Poor's also lowered its rating on the Commonwealth's general obligation bonds in 2005 from "A-" to "BBB." On February 24, 2006, Moody's placed the Commonwealth's "Baa2" general obligation rating on "watchlist." The "watchlist" action places the Commonwealth's "Baa2" general obligation rating under review for possible downgrade. Moody's has indicated that the review is expected to be completed by mid-July 2006 or possibly earlier. Other bonds issued by various Commonwealth agencies and whose credit is tied directly or indirectly to that of the Commonwealth were also placed on "watchlist."

The ratings reflect only the respective opinions of such rating agencies. Any explanation of the significance of such ratings must be obtained from the respective rating agency. There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies if, in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such rating or ratings may have an adverse effect on the market prices of the Bonds.

The Commonwealth's total long-term obligations increased by \$2.1 billion during the current fiscal year, representing a 9% increase. Additional information on the Commonwealth's long-term obligations can be found in note 14 to the basic financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The unemployment rate for the Commonwealth of Puerto Rico is currently 10.6%, which is a decrease from a rate of 11.4% a year ago.

Based on the projections of the Puerto Rico Planning Board, the Puerto Rico economy is expected to reflect a real growth of 2.7% for the fiscal year 2006.

In response to the general fund deficit, the Commonwealth has taken legislative and executive actions intended to eliminate such deficits through a comprehensive tax and fiscal spending reform. The combination of these actions, designed to increase recurring revenues and control government spending, is intended to eliminate the Commonwealth's structural budget deficit by fiscal year 2008.

COMMONWEALTH OF PUERTO RICO

Management's Discussion and Analysis

June 30, 2005

On November 21, 2005, as a result of a joint effort by the two principal political parties to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Commonwealth's Legislature approved, and the Governor signed, Joint Resolution No. 321 (the "Joint Resolution"). On the same day, the Governor issued an Executive Order implementing the fiscal measures defined in the Joint Resolution. The Joint Resolution and the Fiscal Reform Executive Order impose government-wide expenditure controls and set forth the basic principles and parameters that will govern the reform of the Commonwealth's tax system and fiscal policy and practices. The proposed tax reform is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based tax on the retail sale of articles of use and consumption (the "Consumption Tax")

The Joint Resolution and the Fiscal Reform Executive Order come in the wake of expenditure controls to be implemented during fiscal year 2006 which includes a reduction of appointed government positions, a limitation on the creation of new temporary employee positions, a hiring freeze, and a voluntary work week reduction program, as well as limitations on central government vehicle fleets and other expenses.

The consolidated budget for the fiscal year 2005-06 amounts to \$24.7 billion. From this amount, \$18.9 billion is assigned to operating expenses, \$2.9 billion to a permanent capital improvements program, and \$2.9 billion for the debt service.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's residents, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Commonwealth's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Department of the Treasury of the Commonwealth of Puerto Rico, Área de Contabilidad Central, P.O. Box 9024140, San Juan, Puerto Rico 00902-4140.

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets (Deficit)

June 30, 2005

(In thousands)

	Primary Government			Component units
	Governmental activities	Business – type activities	Totals primary government	
Assets				
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 426,659	675,193	1,101,852	2,150,980
Cash and cash equivalents deposited in component unit banks	537,401	138,575	675,976	521,629
Investments	227,277	—	227,277	2,482,695
Receivables, (net of allowance for uncollectibles):				
Taxes	1,089,636	—	1,089,636	84,882
Insurance premiums	—	61,396	61,396	—
Intergovernmental	198,775	—	198,775	64,003
Accounts	133,688	—	133,688	770,763
Loans	10,821	—	10,821	3,545,569
Accrued interest	6,870	2,526	9,396	178,849
Other	101,048	11,419	112,467	37,729
Due from:				
Primary government	—	—	—	103,209
Component units	99,999	9,670	109,669	2,221,922
Other governmental entities	3,190	—	3,190	181,147
Internal balances	12,560	(12,560)	—	—
Inventories	23,490	—	23,490	291,079
Prepaid expenses	7,269	—	7,269	71,143
Other assets	19,311	—	19,311	—
Restricted assets:				
Cash and cash equivalents in commercial banks and U.S. Treasury	1,032,900	—	1,032,900	666,678
Cash and cash equivalents deposited in component unit banks	908,824	—	908,824	968,898
Investments and other restricted assets	—	33,940	33,940	7,160,502
Long-term investments	—	—	—	1,243,084
Long-term receivables from:				
Intergovernmental	—	1,906	1,906	—
Loans	—	—	—	103,830
Long-term amounts due from:				
Primary government	—	—	—	127,701
Component units	—	145,823	145,823	40,544
Other governmental entities	—	—	—	28,641
Real estate held for sale or future development	46,484	—	46,484	208,392
Deferred expenses and other assets	199,175	41,079	240,254	428,128
Capital assets (net of accumulated depreciation):				
Land and other nondepreciable assets	2,202,082	—	2,202,082	14,356,144
Depreciable assets	4,916,951	1,367	4,918,318	15,390,404
Total assets	\$ 12,204,410	1,110,334	13,314,744	53,428,545

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets (Deficit)

June 30, 2005

(In thousands)

	Primary Government			Component units
	Governmental activities	Business – type activities	Totals primary government	
Liabilities				
Accounts payable and accrued liabilities	\$ 1,573,918	6,350	1,580,268	2,326,121
Deposits and escrow liabilities	—	—	—	5,753,711
Tax refunds payable	200,637	—	200,637	—
Due to:				
Primary government	—	—	—	102,561
Component units	94,362	—	94,362	1,116,814
Other governmental entities	245	—	245	29,659
Securities lending transactions and reverse repurchase agreements	—	—	—	695,684
Interest payable	495,290	—	495,290	411,167
Deferred revenue	188,038	25,636	213,674	127,035
Other current liabilities	62,844	—	62,844	—
Tax revenue anticipation notes payable	800,000	—	800,000	—
Insurance benefits payable	—	71,028	71,028	841,579
Liabilities payable within one year:				
Bonds	200,470	—	200,470	655,538
Commonwealth appropriation bonds	78,365	—	78,365	4,683
Notes	219,269	—	219,269	1,376,786
Obligations under capital lease arrangements	6,296	—	6,296	—
Compensated absences	838,933	3,468	842,401	199,614
Lottery prizes	—	36,336	36,336	—
Other long-term liabilities	469,861	—	469,861	59,609
Due to primary government – long-term portion	—	—	—	152,931
Due to component units – long-term portion	—	—	—	1,145,274
Deferred revenue – long-term portion	40,215	—	40,215	16,290
Liabilities payable after one year:				
Bonds	12,094,587	—	12,094,587	18,282,278
Commonwealth appropriation bonds	2,636,874	—	2,636,874	1,021,635
Notes	1,975,170	520	1,975,690	654,128
Obligations under capital lease arrangements	140,380	—	140,380	—
Net pension obligation	4,479,795	—	4,479,795	—
Compensated absences	612,387	3,374	615,761	304,525
Lottery prizes	—	292,772	292,772	—
Other long-term liabilities	913,263	—	913,263	387,187
Total liabilities	\$ 28,121,199	439,484	28,560,683	35,664,809
Invested in capital assets, net of related debt	\$ 3,623,158	847	3,624,005	14,614,607
Restricted for:				
Trust – nonexpendable	—	—	—	1,636,837
Capital projects	119,211	214,231	333,442	954,126
Debt service	153,873	—	153,873	1,618,309
Payment of insurance benefits	—	657,984	657,984	—
Affordable housing and related loan insurance programs	23,608	—	23,608	313,034
Student loans and other educational purposes	—	—	—	18,257
Other	—	—	—	110,866
Unrestricted deficit	(19,836,639)	(202,212)	(20,038,851)	(1,502,300)
Total net assets (deficit)	\$ (15,916,789)	670,850	(15,245,939)	17,763,736

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Activities

Year ended June 30, 2005

(In thousands)

Functions	Expenses	Program Revenue			Net (Expense) Revenue and Changes in Net Assets			
		Charges for services	Operating grants and contributions	Capital grants and contributions	Primary Government		Component units	
					Governmental activities	Business-type activities		Total
Primary government:								
Governmental activities:								
Current:								
General government	\$ 1,827,816	445,396	62,514	—	(1,319,906)	—	(1,319,906)	—
Public safety	2,580,951	41,325	76,705	1,212	(2,461,709)	—	(2,461,709)	—
Health	2,364,110	105,220	646,152	—	(1,612,738)	—	(1,612,738)	—
Public housing and welfare	3,443,886	31,825	2,193,533	119,230	(1,099,298)	—	(1,099,298)	—
Education	5,000,686	1,945	1,096,479	641	(3,901,621)	—	(3,901,621)	—
Economic development	1,006,945	76,980	20,821	—	(909,144)	—	(909,144)	—
Interest and other	845,556	—	—	—	(845,556)	—	(845,556)	—
Total governmental activities	17,069,950	702,691	4,096,204	121,083	(12,149,972)	—	(12,149,972)	—
Business-type activities:								
Lotteries	699,407	868,276	—	—	—	168,869	168,869	—
Unemployment	197,967	258,914	14,862	—	—	75,809	75,809	—
Other	32,437	59,819	7,453	—	—	34,835	34,835	—
Total business-type activities	929,811	1,187,009	22,315	—	—	279,513	279,513	—
Total primary government	\$ 17,999,761	1,889,700	4,118,519	121,083	(12,149,972)	279,513	(11,870,459)	—
Component units:								
Government Development Bank for Puerto Rico	\$ 585,462	466,316	—	145,443	—	—	—	26,297
Puerto Rico Highway and Transportation Authority	409,928	191,692	—	127,984	—	—	—	(90,252)
Puerto Rico Electric Power Authority	3,134,944	3,043,834	—	40,556	—	—	—	(50,554)
Puerto Rico Aqueduct and Sewer Authority	764,566	313,819	19,385	—	—	—	—	(431,362)
Puerto Rico Infrastructure Financing Authority	476,447	—	—	—	—	—	—	(476,447)
Puerto Rico Health Insurance Administration	1,459,765	407,851	—	—	—	—	—	(1,051,914)
University of Puerto Rico	1,234,875	160,362	249,155	5,000	—	—	—	(820,358)
Other component units	2,556,337	1,703,034	33,226	22,787	—	—	—	(797,290)
Total component units	\$ 10,622,324	6,286,908	301,766	341,770	—	—	—	(3,691,880)
General revenue:								
Taxes:								
Income taxes					\$ 5,526,006	—	5,526,006	—
Excise taxes					2,101,216	—	2,101,216	373,380
Other taxes					7,128	—	7,128	—
Revenue from global tobacco settlement agreement					106,521	—	106,521	—
Revenue from Tourism Company of Puerto Rico					85,345	—	85,345	—
Revenue from Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority					30,000	—	30,000	—
Revenue from Governing Board of 911 Services					8,390	—	8,390	—
Revenue from Puerto Rico Infrastructure Financing Authority					317,195	—	317,195	—
Revenue from State Insurance Fund Corporation					33,139	—	33,139	—
Grants and contributions not restricted to specific programs					228,990	—	228,990	10,088
Payments from primary government					—	—	—	2,645,096
Unrestricted investment earnings					116,686	32,284	148,970	615,048
Gain on sale of assets					—	—	—	15,563
Other					195,886	—	195,886	27,607
Transfers					492,776	(492,776)	—	—
Total general revenue and transfers					9,249,278	(460,492)	8,788,786	3,686,782
Change in net assets					(2,900,694)	(180,979)	(3,081,673)	(5,098)
Net assets – beginning of year (as restated)					(13,016,095)	851,829	(12,164,266)	17,768,834
Net assets – end of year					\$ (15,916,789)	670,850	(15,245,939)	17,763,736

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2005

(In thousands)

Assets	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Cash and cash equivalents in commercial banks	\$ —	—	—	—	426,659	426,659
Cash and cash equivalents deposited in component unit banks	192,428	284,627	—	43,127	17,219	537,401
Investments	—	—	—	111,838	115,439	227,277
Receivables, net of allowance for uncollectibles:						
Taxes	1,089,636	—	—	—	—	1,089,636
Intergovernmental	181,646	17,129	—	—	—	198,775
Accounts	119,469	—	—	—	14,219	133,688
Loans	10,785	—	—	—	36	10,821
Accrued interest	3,719	2,609	—	535	7	6,870
Other	8,546	—	—	—	—	8,546
Due from:						
Other funds	60,586	—	—	—	116,672	177,258
Component units	62,100	—	—	—	37,899	99,999
Other governmental entities	142	—	—	—	3,048	3,190
Restricted assets:						
Cash and cash equivalents in commercial banks	705,233	—	209,689	—	117,978	1,032,900
Cash and cash equivalents deposited in component unit banks	889,639	19,185	—	—	—	908,824
Other assets	19,311	—	—	—	—	19,311
Real estate held for future development	45,691	—	—	—	793	46,484
Total assets	\$ 3,388,931	323,550	209,689	155,500	849,969	4,927,639

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2005

(In thousands)

Liabilities and Fund Balances	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Liabilities:						
Accounts payable and accrued liabilities	\$ 1,384,416	—	91,878	6,694	90,930	1,573,918
Other liabilities	101,411	8,349	—	—	—	109,760
Tax refunds payable	200,637	—	—	—	—	200,637
Due to:						
Other funds	164,698	—	—	—	—	164,698
Other governmental entities	245	—	—	—	—	245
Component units	69,427	—	—	—	11,885	81,312
Notes payable	174,209	—	12,303	—	—	186,512
Bonds payable	—	132,585	—	—	46,160	178,745
Interest payable	26,768	174,832	—	—	66,110	267,710
Deferred revenue	978,391	—	—	—	—	978,391
Tax revenue anticipation notes	800,000	—	—	—	—	800,000
Total liabilities	3,900,202	315,766	104,181	6,694	215,085	4,541,928
Fund Balances (deficit):						
Reserved for:						
Encumbrances	732,467	—	—	—	45,546	778,013
Capital projects	—	—	—	—	—	—
Assets in liquidation	66,467	—	—	—	—	66,467
Low income housing assistance	23,608	—	—	—	—	23,608
Unreserved (deficit) reported in:						
General fund	(1,333,813)	—	—	—	—	(1,333,813)
Debt service funds	—	7,784	—	—	148,781	156,565
Special revenue funds	—	—	—	148,806	108,143	256,949
Capital project funds	—	—	105,508	—	332,414	437,922
Total fund balances (deficit)	(511,271)	7,784	105,508	148,806	634,884	385,711
Total liabilities and fund balances (deficit) \$	3,388,931	323,550	209,689	155,500	849,969	4,927,639

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Reconciliation of the Balance Sheet to the Statement of Net Assets – Governmental Funds

Year ended June 30, 2005

(In thousands)

Amounts reported for governmental activities in the statement of net assets
are different because:

Total fund balances of governmental funds	\$ 385,711
Inventories and prepaid expenses that are not available to pay for current period expenditures, and therefore are not recognized in the funds	30,759
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	7,119,033
Long-term account receivable from global tobacco settlement agreement and PBA	92,502
The difference between the proceeds of Qualified Zone Academic Bonds (QZAB) issued and the amounts paid to escrow agent to “early defease” such bonds is deferred in the statement of net assets and amortized over the life of the QZAB. Since such difference did not provide current financial resources, it is not reported in the funds	(40,215)
Deferred revenue in governmental funds that are recognized as revenue in the governmental activities	790,353
Debt issued by the Commonwealth have associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets	189,064
Net pension asset of the Commonwealth related to the Puerto Rico Judiciary Retirement System recognized in governmental activities is not a financial resource and therefore is not reported in the funds	10,111
Liabilities, including Commonwealth appropriation bonds (\$2,715,239), bonds payable (\$12,116,312), notes payable (\$2,007,927), capital leases payable (\$146,676), long-term portion of compensated absences (\$1,451,320), net pension obligation (\$4,479,795) and other long-term liabilities (\$1,336,208) are not due and payable in the current period and therefore are not reported in the funds	(24,253,477)
Liability to component unit not due and payable in the current period and therefore is not reported in the funds.	(13,050)
Interest liabilities are not due and payable in the current period and therefore are not reported in the funds	(227,580)
Deficit of governmental activities	<u>\$ (15,916,789)</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
Statement of Revenue, Expenditures, and Changes in Fund Balances –
Governmental Funds
Year ended June 30, 2005
(In thousands)

	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Revenue:						
Taxes:						
Income taxes	\$ 5,564,672	—	—	—	—	5,564,672
Excise taxes	2,101,216	—	—	—	—	2,101,216
Other taxes	8,752	—	—	—	—	8,752
Charges for services	702,691	—	—	—	—	702,691
Revenue from global tobacco settlement agreement	—	—	—	—	71,461	71,461
Revenues from component units:						
Puerto Rico Infrastructure Financing Authority	317,195	—	—	—	—	317,195
Governing Board of 911 Services	8,390	—	—	—	—	8,390
Tourism Company of Puerto Rico	85,345	—	—	—	—	85,345
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control						
Facilities Financing Authority	30,000	—	—	—	—	30,000
State Insurance Fund Corporation	33,139	—	—	—	—	33,139
Intergovernmental	4,323,926	122,350	—	—	—	4,446,276
Interest and investment earnings	91,689	3,205	—	4,406	17,386	116,686
Other	185,625	—	—	—	10,261	195,886
	<u>13,452,640</u>	<u>125,555</u>	<u>—</u>	<u>4,406</u>	<u>99,108</u>	<u>13,681,709</u>
Expenditures:						
Current:						
General government	1,332,837	—	—	—	342,591	1,675,428
Public safety	2,366,237	—	—	—	43,431	2,409,668
Health	2,332,674	—	—	6,924	4,924	2,344,522
Public housing and welfare	3,291,291	—	—	—	29,558	3,320,849
Education	4,028,478	—	—	21,215	127,971	4,177,664
Economic development	622,156	—	—	24,044	59,866	706,066
Capital outlays	298,027	—	254,202	—	113,401	665,630
Debt service:						
Principal	199,344	132,585	—	—	59,625	391,554
Interest and other	219,107	358,809	—	391	147,903	726,210
Debt issuance costs	—	—	—	1,663	6,058	7,721
	<u>14,690,151</u>	<u>491,394</u>	<u>254,202</u>	<u>54,237</u>	<u>935,328</u>	<u>16,425,312</u>
Excess of expenditures over revenue	<u>(1,237,511)</u>	<u>(365,839)</u>	<u>(254,202)</u>	<u>(49,831)</u>	<u>(836,220)</u>	<u>(2,743,603)</u>
Other financing sources (uses):						
Transfers in	1,051,854	377,384	10,744	403	305,607	1,745,992
Transfers out	(893,138)	—	—	(236,060)	(124,018)	(1,253,216)
Long-term debt issued	930,787	—	—	108,209	580,566	1,619,562
Bond issue discount	—	—	—	(6,078)	—	(6,078)
Capital leases	847	—	—	—	—	847
	<u>1,090,350</u>	<u>377,384</u>	<u>10,744</u>	<u>(133,526)</u>	<u>762,155</u>	<u>2,107,107</u>
Net change in fund balances (deficit)	<u>(147,161)</u>	<u>11,545</u>	<u>(243,458)</u>	<u>(183,357)</u>	<u>(74,065)</u>	<u>(636,496)</u>
Fund balances at beginning of year (as restated)	<u>(364,110)</u>	<u>(3,761)</u>	<u>348,966</u>	<u>332,163</u>	<u>708,949</u>	<u>1,022,207</u>
Fund balances at end of year	<u>\$ (511,271)</u>	<u>7,784</u>	<u>105,508</u>	<u>148,806</u>	<u>634,884</u>	<u>385,711</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities – Governmental Funds

Year ended June 30, 2005

(In thousands)

Amounts reported for governmental activities in the statement of activities
are different because:

Net change in fund balances – total governmental funds	\$ (636,496)
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Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays (\$665,630) exceeded depreciation (\$210,640) in the current period.	454,990
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In the statement of activities, only the losses on the sale of capital assets is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Therefore, the change in the net assets differs from the change in fund balance by the cost of the asset sold.	(10,791)
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Revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the governmental funds.	33,419
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Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which net proceeds (\$1,614,331) exceeded repayments (\$391,554).	(1,222,777)
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Repayments of advances from a component unit provided current financial resources to governmental funds, but reduced the liability to component units in the statement of net assets.	3,112
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Income tax revenue that are not currently available are deferred in the governmental funds, but are accruable as revenue in the statement of activities. This is the amount by which deferred revenue increased during the year.	(38,666)
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Governmental funds do not report transfers of long-term assets or liabilities because such transfers do not represent financial resources, however they are recorded in the statement of activities. This amount represents the transfer of property by the Commonwealth to certain municipalities (see note 12)	(804)
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Generally, inventory and prepayments are recorded as expenditures in the governmental funds when purchased rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This is the sum of the decrease in inventory (\$1,186) and net pension asset (\$1,910) for the year.	(3,096)
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Debt issuance costs are expenditures to governmental funds, but are deferred assets in the statement of net assets. This is the amount of debt issue costs for the year.	7,721
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Certain interest and other costs reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount equivalent to the increase in interest payable (\$113,537), combined with the amortization of debt issue costs (\$10,593), and the net accretion and amortization of debt issue discount and deferred losses (\$58,942).	(183,072)
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Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount by which the net increases in net pension obligation (\$302,408), Christmas bonus liability (\$64,713), liability in federal cost disallowances (\$21,615), liability for legal claims and judgments (\$722,116), and accrued compensated absences (\$42,442) exceeded the net decreases in other liabilities (\$150,940)	(1,304,234)
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Change in deficit of governmental activities

\$ <u>(2,900,694)</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

**Statement of Revenue and Expenditures – Budget and Actual –
Budget Basis – General Fund**

Year ended June 30, 2005
(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Revenue:				
Income taxes	\$ 5,532,000	5,557,000	5,485,950	(71,050)
Excise taxes	2,049,000	2,036,000	2,047,998	11,998
Other taxes	93,000	94,000	96,294	2,294
Charges for services	208,000	218,000	230,382	12,382
Intergovernmental	30,000	24,000	26,731	2,731
Revenue from component units	80,000	80,000	432,708	352,708
Other	152,000	152,000	282,852	130,852
Total revenue	<u>8,144,000</u>	<u>8,161,000</u>	<u>8,602,915</u>	<u>441,915</u>
Expenditures:				
Current:				
General government	492,731	491,104	551,592	(60,488)
Public safety	1,917,149	1,911,419	1,994,429	(83,010)
Health	1,322,398	1,331,273	1,415,762	(84,489)
Public housing and welfare	449,171	447,169	533,678	(86,509)
Education	2,847,236	2,848,157	3,251,344	(403,187)
Economic development	534,418	533,983	541,910	(7,927)
Intergovernmental	381,610	381,608	425,940	(44,332)
Debt service:				
Principal	70,518	70,518	80,633	(10,115)
Interest and other	112,657	112,657	112,946	(289)
Total expenditures	<u>8,127,888</u>	<u>8,127,888</u>	<u>8,908,234</u>	<u>(780,346)</u>
Excess (deficiency) of revenue over (under) expenditures	<u>16,112</u>	<u>33,112</u>	<u>(305,319)</u>	<u>(338,431)</u>
Other financing sources (uses):				
Notes payable issued	550,000	550,000	756,689	(206,689)
Transfer in	160,000	143,000	432,649	(289,649)
Transfer out	(726,112)	(726,112)	(808,797)	82,685
Total other financing sources (uses)	<u>(16,112)</u>	<u>(33,112)</u>	<u>380,541</u>	<u>(413,653)</u>
Excess of revenue and other financing sources over expenditures and other financing uses	<u>\$ —</u>	<u>—</u>	<u>75,222</u>	<u>75,222</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets – Proprietary Funds

June 30, 2005

(In thousands)

Assets	Unemployment insurance	Lotteries	Other proprietary	Totals
Current assets:				
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 520,905	31,187	123,101	675,193
Cash and cash equivalents in component unit banks	—	82,177	56,398	138,575
Receivables, net:				
Insurance premiums, net	56,304	—	5,092	61,396
Component units	—	—	9,670	9,670
Due from other funds	—	48,026	—	48,026
Accrued interest	579	—	1,947	2,526
Other	8,900	2,212	307	11,419
Investments:				
Restricted investments	—	—	33,940	33,940
Total current assets	586,688	163,602	230,455	980,745
Noncurrent assets:				
Loans receivable, excluding current portion, net:				
Component units	—	—	145,823	145,823
Intergovernmental	—	—	1,906	1,906
Capital assets, net	—	1,367	—	1,367
Other	—	41,079	—	41,079
Total assets	\$ 586,688	206,048	378,184	1,170,920
Liabilities and Net Assets (Deficit)				
Current liabilities:				
Accounts payable and accrued liabilities	\$ —	1,060	5,290	6,350
Due to other funds	5,789	54,797	—	60,586
Deferred revenue	8,503	17,104	29	25,636
Compensated absences	—	2,308	1,160	3,468
Lottery awards	—	36,336	—	36,336
Insurance benefits payable	69,833	—	1,195	71,028
Total current liabilities	84,125	111,605	7,674	203,404
Noncurrent liabilities:				
Compensated absences	—	2,516	858	3,374
Lottery awards	—	292,772	—	292,772
Notes payable	—	520	—	520
Total liabilities	84,125	407,413	8,532	500,070
Net assets (deficit):				
Invested in capital assets, net of related debt	—	847	—	847
Restricted for:				
Payment of insurance benefits	502,563	—	155,421	657,984
Capital projects	—	—	214,231	214,231
Unrestricted	—	(202,212)	—	(202,212)
Total net assets (deficit)	\$ 502,563	(201,365)	369,652	670,850

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
Statement of Revenue, Expenses, and Changes in Net Assets –
Proprietary Funds
Year ended June 30, 2005
(In thousands)

	Unemployment insurance	Lotteries	Other proprietary	Totals
Operating revenues:				
Lottery ticket sales	\$ —	868,276	—	868,276
Insurance premiums	258,914	—	53,874	312,788
Interest	—	—	5,945	5,945
Total operating revenues	<u>258,914</u>	<u>868,276</u>	<u>59,819</u>	<u>1,187,009</u>
Operating expenses:				
Lottery awards	\$ —	563,189	—	563,189
Insurance benefits	197,967	—	5,903	203,870
General, administrative, and other operating expenses	—	135,832	26,534	162,366
Depreciation and amortization	—	386	—	386
Total operating expenses	<u>197,967</u>	<u>699,407</u>	<u>32,437</u>	<u>929,811</u>
Operating income	<u>60,947</u>	<u>168,869</u>	<u>27,382</u>	<u>257,198</u>
Nonoperating revenue:				
Contributions from federal government	14,862	—	7,453	22,315
Interest and investment earnings	32,284	—	—	32,284
Total nonoperating revenue	<u>47,146</u>	<u>—</u>	<u>7,453</u>	<u>54,599</u>
Income before transfers	108,093	168,869	34,835	311,797
Transfers from general fund	197,967	—	1,436	199,403
Transfers to general fund	<u>(323,310)</u>	<u>(368,869)</u>	<u>—</u>	<u>(692,179)</u>
Net change in net assets (deficit)	(17,250)	(200,000)	36,271	(180,979)
Net assets (deficit) at beginning of year	<u>519,813</u>	<u>(1,365)</u>	<u>333,381</u>	<u>851,829</u>
Net assets (deficit) at end of year	<u>\$ 502,563</u>	<u>(201,365)</u>	<u>369,652</u>	<u>670,850</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Cash Flows –

Proprietary Funds

Year ended June 30, 2005

(In thousands)

	Business-type activities - enterprise funds			
	Unemployment insurance	Lotteries	Other funds	Totals
Cash flows from operating activities:				
Receipts from customers and users	\$ 248,066	868,276	52,351	1,168,693
Other receipts	—	—	11,863	11,863
Payments to suppliers and employees	—	(138,465)	(27,409)	(165,874)
Payment of lottery prizes	—	(552,552)	—	(552,552)
Payments of insurance benefits	(197,967)	—	(5,982)	(203,949)
Other payments	(7,538)	—	(10,046)	(17,584)
Net cash provided by operating activities	42,561	177,259	20,777	240,597
Cash flows from noncapital financing activities:				
Intergovernmental grants and contributions	14,862	—	7,453	22,315
Principal payments of notes payable	—	(853)	—	(853)
Proceeds from issuance of notes payable to component units	—	197	—	197
Transfers from other funds	197,967	—	1,436	199,403
Transfers to other funds	(323,310)	(368,869)	—	(692,179)
Net cash provided by (used in) noncapital financing activities	(110,481)	(369,525)	8,889	(471,117)
Cash flows from capital and related financing activities:				
Capital expenditures	—	(81)	—	(81)
Net cash used in capital and related financing activities	—	(81)	—	(81)
Cash flows from investing activities:				
Interest received on deposits and investments	32,284	—	2,098	34,382
Other investment income received	—	—	201	201
Net cash provided by investing activities	32,284	—	2,299	34,583
Net increase (decrease) in cash and cash equivalents	(35,636)	(192,347)	31,965	(196,018)
Cash and equivalents at beginning of year	556,541	305,711	147,534	1,009,786
Cash and cash equivalents at end of year	\$ 520,905	113,364	179,499	813,768
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	\$ 60,947	168,869	27,382	257,198
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation and amortization	—	386	—	386
Interest earned on deposits, loans and investments	—	—	(2,058)	(2,058)
Changes in operating assets and liabilities:				
Increase (decrease) in accounts and loans receivable	(10,848)	470	(3,198)	(13,576)
Increase in other assets	—	(793)	—	(793)
Increase in obligation for unpaid lottery awards	—	10,637	—	10,637
Decrease in due to other funds	(8,888)	(9,583)	—	(18,471)
Increase (decrease) in deferred revenues	1,350	5,353	(33)	6,670
Increase in compensated absences	—	981	249	1,230
Increase in liability for insurance benefits payable	—	—	98	98
Increase (decrease) in accounts payable and accrued liabilities	—	939	(1,663)	(724)
Total adjustments	(18,386)	8,390	(6,605)	(16,601)
Net cash provided by operating activities	\$ 42,561	177,259	20,777	240,597

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Fiduciary Net Assets

June 30, 2005

(In thousands)

Assets	Pension trust	Special deposits – agency
Cash and cash equivalents in commercial banks:		
Unrestricted	\$ 94,017	467,319
Restricted	4,448	—
Cash and cash equivalents in component unit banks:		
Unrestricted	32,808	110,102
Restricted	1,578	—
Investments:		
Debt and equity securities, at fair value	3,526,161	16,115
Investment in PRTA Holdings, at appraised value	486,080	—
Other	85,991	—
Receivables, net:		
Accounts	40,695	—
Loans and advances	810,776	—
Accrued interest and dividends	6,915	—
Due from general fund of the Commonwealth	17,513	—
Other	35,152	—
Capital assets, net	34,617	—
Other assets	8,364	—
Total assets	5,185,115	593,536
Liabilities		
Accounts payable and accrued liabilities	67,019	583,536
Repurchase agreements	138,000	—
Due to component unit	4	—
Other liabilities	—	10,000
Bonds payable	21,285	—
Total liabilities	226,308	593,536
Net Assets		
Net assets held in trust for pension and other benefits	\$ <u>4,958,807</u>	<u>—</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2005

(In thousands)

Additions:

Contributions:

Sponsor	\$	502,180
Participants		466,632
Special		75,584

Total contributions		<u>1,044,396</u>
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Interests		98,654
Dividends		39,657

Net change in fair value of investments, including realized losses on sale and maturities of investments		352,576
Investment expenses		<u>(8,933)</u>

Net interest and investment income		<u>481,954</u>
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Other income		<u>9,092</u>
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Total additions		<u>1,535,442</u>
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Deductions:

Pension and other benefits		1,103,072
Refunds of contributions		22,593
General and administrative expenses		<u>63,258</u>

Total deductions		<u>1,188,923</u>
------------------	--	------------------

Net change in net assets held in trust for pension and other benefits		346,519
--	--	---------

Net assets held in trust for pension and other benefits:		
Beginning of year		<u>4,612,288</u>
End of year	\$	<u><u>4,958,807</u></u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
Combining Statement of Net Assets —

Major Component Units

June 30, 2005

(In thousands)

	Government Development Bank for Puerto Rico	Puerto Rico Highway and Transportation Authority	Puerto Rico Electric Power Authority	Puerto Rico Aqueduct and Sewer Authority	Major Component Units			University of Puerto Rico	Nonmajor component units	Total component units
					Puerto Rico Infrastructure Financing Authority	Puerto Rico Health Insurance Administration	Puerto Rico			
Assets										
Current assets:										
Cash and cash equivalents in commercial banks	\$ 1,793,536	48,507	21,282	70,098	—	11,492	17,647	188,418	2,150,980	
Cash and cash equivalents in component unit banks	—	—	—	40,000	59,834	3,605	17,607	400,583	521,629	
Investments, including collateral from securities lending transactions	940,308	—	—	—	470	—	51,045	1,490,872	2,482,695	
Receivables, net:										
Insurance premium	—	—	—	—	—	—	—	84,882	84,882	
Intergovernmental	—	11,358	—	4,181	—	4,192	40,858	3,414	64,003	
Accounts	—	5,683	555,549	31,770	—	—	11,414	166,347	770,763	
Loans	3,489,488	—	—	—	—	—	—	56,081	3,545,569	
Accrued interest	142,073	2,240	—	—	1,254	13	—	33,269	178,849	
Other governmental entities	—	—	87,534	18,581	3,112	12,376	12,822	46,722	181,147	
Other	—	—	—	201	34	5,479	263	31,752	37,729	
Due from:										
Primary government	—	—	6,327	—	—	—	47,687	49,195	103,209	
Component units	2,159,424	—	16,716	—	—	—	15,645	30,137	2,221,922	
Inventories	—	—	240,136	12,746	—	—	9,835	28,362	291,079	
Prepaid expenses	—	4,167	25,893	81	1,597	16	27,594	11,795	71,143	
Total current assets	8,524,829	71,955	953,437	177,658	66,301	37,173	252,417	2,621,829	12,705,599	
Noncurrent assets:										
Restricted assets:										
Cash and cash equivalents in commercial banks	43,165	9,412	340,472	148	71,609	—	27,195	174,677	666,678	
Cash and cash equivalents in component unit banks	—	30,218	—	40,977	24,960	—	—	872,743	968,898	
Investments and other restricted assets	1,668,367	757,825	457,905	—	2,782,704	—	83,766	1,409,935	7,160,502	
Investments	—	—	—	—	—	—	—	1,243,084	1,243,084	
Receivables:										
Loans, interest and other	—	—	—	—	—	—	2,479	101,351	103,830	
Other governmental entities	—	—	26,803	—	—	—	—	1,838	28,641	
Due from:										
Primary government	13,050	—	43,081	—	—	—	71,570	—	127,701	
Component units	—	—	—	—	—	—	—	40,544	40,544	
Property held for sale or future development	23,558	—	38,867	—	—	—	—	145,967	208,392	
Capital assets, not being depreciated	12,598	9,441,088	1,837,052	495,303	955,086	—	264,159	1,350,858	14,356,144	
Capital assets, depreciable, net	12,679	5,657,202	3,252,453	4,188,699	118	307	449,782	1,829,164	15,390,404	
Deferred expenses and other assets	67,880	114,327	120,975	30,071	70,290	—	—	24,585	428,128	
Total noncurrent assets	1,841,297	16,010,072	6,117,608	4,755,198	3,904,767	307	898,951	7,194,746	40,722,946	
Total assets	\$ 10,366,126	\$ 16,082,027	\$ 7,071,045	\$ 4,932,856	\$ 3,971,068	\$ 37,480	\$ 1,151,368	\$ 9,816,575	\$ 53,428,545	

COMMONWEALTH OF PUERTO RICO
Combining Statement of Net Assets –
Major Component Units
June 30, 2005
(In thousands)

Liabilities and Net Assets		Major Component Units								Total component units	
		Government Development Bank for Puerto Rico	Puerto Rico Highway and Transportation Authority	Puerto Rico Electric Power Authority	Puerto Rico Aqueduct and Sewer Authority	Puerto Rico Infrastructure Financing Authority	Puerto Rico Health Insurance Administration	University of Puerto Rico	Nonmajor component units		
Liabilities:	Current liabilities:										
	Accounts payable and accrued liabilities	120,236	298,237	550,135	274,077	131,606	35,723	126,434	789,673	2,326,121	
	Deposits and escrow liabilities	5,133,716	—	159,376	7,090	—	—	—	453,529	5,753,711	
	Due to:										
	Primary government	—	—	—	9,670	977	25,800	—	67,091	102,561	
	Component units	—	274,999	112,661	—	—	—	1,411	667,108	1,116,814	
	Other governmental entities	—	—	—	—	—	—	—	28,248	29,659	
	Securities lending transactions and reverse repurchase agreements	439,034	143,048	—	—	—	—	—	256,650	695,684	
	Interest payable	24,292	—	126,057	14,608	37,870	—	3,860	61,432	411,167	
	Deferred revenue	—	—	—	—	—	—	19,897	107,138	127,035	
	Notes payable, current portion	1,212,677	—	129,750	—	—	—	—	34,359	1,376,786	
	Commonwealth appropriation bonds, current portion	96	—	—	3,198	99	—	—	1,290	4,683	
	Bonds payable, current portion	86,660	86,660	298,352	24,496	29,165	—	19,560	110,645	655,538	
	Accrued compensated absences	5,620	—	59,065	28,769	87	390	20,944	84,739	199,614	
	Insurance benefit payable	—	—	—	—	—	—	—	841,579	841,579	
	Current portion of other long-term liabilities	—	24,360	—	—	—	—	3,733	31,516	59,609	
	Total current liabilities	7,022,331	827,304	1,435,396	361,908	199,804	61,913	256,908	3,534,997	13,700,561	
Noncurrent liabilities:	Due to:										
	Primary government	—	—	—	145,823	—	—	—	7,108	152,931	
	Component units	—	—	—	303,870	8,534	—	3,894	828,976	1,145,274	
	Deferred revenue	—	—	—	—	—	—	—	16,290	16,290	
	Notes payable	—	—	36,835	—	—	—	—	617,293	654,128	
	Commonwealth appropriation bonds	10,243	—	—	706,078	10,552	—	—	294,762	1,021,635	
	Bonds payable	1,371,389	5,748,255	4,965,022	838,761	3,388,006	—	463,712	1,507,133	18,282,278	
	Accrued compensated absences	—	13,926	139,004	24,392	125	260	106,889	19,929	304,525	
	Other long-term liabilities	—	31,940	—	59,358	6,000	—	63,835	226,054	387,187	
	Total noncurrent liabilities	1,381,632	5,794,121	5,140,861	2,078,282	3,413,217	260	638,330	3,517,545	21,964,248	
	Total liabilities	8,403,963	6,621,425	6,576,257	2,440,190	3,613,021	62,173	895,238	7,052,542	35,664,809	
	Net assets (deficit):	Invested in capital assets, net of related debt									
		Restricted for:									
		Trust — nonexpendable	25,277	8,849,291	77,094	2,955,976	955,204	307	183,741	1,567,717	14,614,607
		Capital projects	—	—	—	—	1,591,527	—	45,310	—	1,636,837
		Debt service	53,374	105,636	409,738	—	398,768	—	5,662	34,322	954,126
		Affordable housing and related loan insurance programs	313,034	504,877	—	—	826,149	—	37,502	196,407	1,618,309
Student loans and other educational purposes		—	—	—	—	—	—	—	—	313,034	
Other specified purposes		—	—	—	—	—	—	7,882	10,375	18,257	
Unrestricted		1,570,478	798	7,956	(504,435)	(3,438,560)	(25,000)	(34,922)	9,860	110,866	
Total net assets (deficit)		1,962,163	9,460,602	494,788	2,492,666	358,047	(24,693)	256,130	945,352	(1,502,300)	
Total liabilities and net assets											
	\$	10,366,126	16,082,027	7,071,045	4,932,856	3,971,068	37,480	1,151,368	9,816,575	53,428,545	

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
Combining Statement of Activities –
Major Component Units
Year ended June 30, 2005
(In thousands)

Component units	Expenses	Program Revenues		Net revenues (expenses) and changes in net assets	General Revenue					Change in net assets	Net assets, beginning of year as restated	Net assets (deficit), end of year
		Charges for services	Operating grants and contributions	Capital grants and contributions	Payments from primary government	Payments from other component units	Grants and contributions not restricted to specific programs	Taxes	Interest and investment earnings	Gain (loss) in sale of assets	Miscellaneous	
Government Development Bank for Puerto Rico	\$ 585,462	466,316	—	145,443	119,728	(500,000)	—	—	—	—	—	1,962,163
Puerto Rico Highway and Transportation Authority	409,928	191,692	—	127,984	—	—	—	312,824	(2,499)	—	—	9,460,602
Puerto Rico Electric Power Authority	3,134,944	3,043,834	—	40,556	—	—	—	—	24,097	—	738	494,788
Puerto Rico Aqueduct and Sewer Authority	764,566	313,819	19,385	—	180,244	120,153	—	—	—	—	5,119	2,492,666
Puerto Rico Infrastructure Financing Authority	476,447	—	—	—	73,700	(120,153)	—	—	377,084	—	—	358,047
Puerto Rico Health Insurance Administration	1,459,765	407,851	—	—	1,024,097	—	—	—	2,882	—	—	(24,693)
University of Puerto Rico	1,234,875	160,362	249,155	5,000	808,893	—	7,285	—	3,155	—	2,511	256,130
Nonmajor component units	2,556,337	1,703,034	33,226	22,787	438,434	500,000	2,803	60,556	210,329	15,563	19,239	2,764,033
	\$ 10,622,324	6,286,908	301,766	341,770	2,645,096	—	10,088	373,380	615,048	15,563	27,607	17,763,736

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

(1) Summary of Significant Accounting Policies

The Commonwealth of Puerto Rico (the Commonwealth) was constituted on July 25, 1952, under the provisions of its Constitution as approved by the people of Puerto Rico and the U.S. Congress. The Commonwealth's Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government. The Commonwealth assumes responsibility for public safety, health, public housing and welfare, education, and economic development.

The accompanying basic financial statements of the Commonwealth have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying basic financial statements present the financial position of the Commonwealth and its various funds, the results of operations of the Commonwealth and its various funds and fund types, and the cash flows of the proprietary funds. The basic financial statements are presented as of June 30, 2005, and for the year then ended. The basic financial statements include the various departments, agencies, boards, commissions, public trusts and public corporations, and any other organizational units governed by the Puerto Rico Legislature and/or officers of the Commonwealth.

(a) *The Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies, and governmental entities whose funds are under the custody and control of the Secretary of the Treasury of the Commonwealth and the Commonwealth's component units pursuant to Act No. 230 of July 23, 1974, as amended, known as Commonwealth of Puerto Rico Accounting Law. The Commonwealth has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Commonwealth to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Commonwealth.

As required by U.S. GAAP, these basic financial statements present the Commonwealth and its component units.

(b) *Component Units*

Component units are entities that are legally separate organizations for which the Commonwealth's elected officials are financially accountable or other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Commonwealth's balances and

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

transactions; or discrete presentation of the component units' financial data in columns separate from the Commonwealth's balances and transactions. The Commonwealth is financially accountable because it appoints the members of the governing authorities of each of the component units and because it is able to impose its will on these organizations or because the organizations provide financial benefits or impose financial burdens on the Commonwealth. The financial statements of the component units discussed below have been included in the financial reporting entity either as blended component units or as discretely presented component units in accordance with GASB Statement No. 14, *The Financial Reporting Entity*, as amended.

Blended Component Units

The following entities, while legally separate from the Commonwealth, meet the criteria to be reported as part of the primary government because they provide services entirely or almost entirely to the Commonwealth.

Public Buildings Authority (PBA) – PBA is governed by a five-member board comprised by the Governor, the Secretary of the Department of Transportation and the Public Works (DTPW), the Secretary of the Department of Education of the Commonwealth, the President of the Government Development Bank for Puerto Rico (GDB), and one member appointed by the Governor of Puerto Rico with the advice and consent of the Senate. It is a legally separate entity, whose activities are blended within the primary government because it exists to construct, purchase, or lease office, school, health, correctional, social welfare, and other facilities for lease to the Commonwealth's departments, component units, and instrumentalities. Bonds issued by PBA to finance such facilities are payable from lease collections, which are largely derived from Commonwealth appropriations and are further secured by the Commonwealth's guaranty.

Puerto Rico Maritime Shipping Authority (PRMSA) – PRMSA is governed by the President of GDB. The operations of PRMSA consist of servicing the long-term liability to third parties that resulted from the sale of certain maritime operations formerly owned and operated by PRMSA. The Commonwealth is required to annually appropriate funds in its general operating budget to provide for the payment of principal and interest on such debt [see note 14 (d)].

The Children's Trust (the Trust) – The Trust is governed by a seven-member board comprised by the Governor, who designated the president of the board, the President of GDB, the Director of the Office of Management and Budget (OMB) of the Commonwealth, the Secretary of Justice of the Commonwealth, and three private citizens appointed by the Governor with the consent of the Senate. The Trust's sole operation consists of providing financial assistance principally to the Commonwealth's departments to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico, especially in the areas of education, recreation, and health. The operation of the Trust is financed with the moneys being received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity.

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Notes to Basic Financial Statements

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Complete financial statements of the blended component units can be obtained directly by contacting their respective administrative offices at:

Public Buildings Authority
P.O. Box 41029 Minillas Station
San Juan, PR 00940-1029

The Children's Trust
P.O. Box 42001
San Juan, PR 00940-2001

Puerto Rico Maritime Shipping Authority
P.O. Box 42001
San Juan, PR 00940-2001

Discretely Presented Component Units

The following component units, consistent with GASB No. 14, are discretely presented in the basic financial statements because of the nature of the services they provide, the Commonwealth's ability to impose its will, principally through the appointment of their governing authorities and because the component units provide specific financial benefits to, or impose financial burdens on the Commonwealth. These have been classified by management between major and nonmajor component units.

Major Component Units

Government Development Bank for Puerto Rico (GDB) – is governed by a seven-member board appointed by the Governor. GDB acts as fiscal agent, depository of funds, disbursing agent, and financial advisor for the Commonwealth, its public corporations, and municipalities in connection with the issuance of bonds and notes; and it also makes loans and advances funds predominantly to the Commonwealth's departments, component units, and municipalities. GDB's Board of directors members are executives on a trustworthy position, named and supervised by the Governor. The Commonwealth provides financial support to GDB through legislative appropriations.

Puerto Rico Aqueduct and Sewer Authority (PRASA) – PRASA is governed by a nine-member board comprised of five members appointed by the Governor, the Secretary of DTPW, the President of GDB, and two members elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. PRASA owns and operates the system of public water supply and sanitary sewer facilities. PRASA is authorized, among other things, to borrow money and issue revenue bonds for any of its corporate purposes. Through the approval of Act No. 328 of 1998, as discussed in note 15 (a), the Commonwealth guarantees the principal and interest payments of certain outstanding bonds and of all future bonds issued to refinance those outstanding bonds, and other loans under the State Revolving Fund Program. The Commonwealth provides financial support to PRASA through legislative appropriations.

Puerto Rico Electric Power Authority (PREPA) – PREPA is governed by a nine-member board comprised of the Secretary of DTPW, six members appointed by the Governor with the advice and consent of the Senate, and two members representing the consumers' interest elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. Board members are appointed or elected for a period of four years. PREPA is responsible for conserving, developing, and utilizing the

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

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power resources of Puerto Rico and owns and operates the Commonwealth's electrical power generation, transmission, and distribution system. The Commonwealth provides financial support to PREPA through legislative appropriation.

Puerto Rico Health Insurance Administration (PRHIA) – PRHIA is governed by a seven-member board comprised by the Secretary of Health of the Commonwealth, the Secretary of the Treasury of the Commonwealth, the Insurance Commissioner of Puerto Rico, and four additional members appointed by the Governor, with the consent of the Senate, including two professionals with competence in the *insurance* industry and health services, and two representing the public interest. PRHIA was created for implementing, administering, and negotiating a health insurance system through contracts with insurance underwriters to provide quality medical and hospital care to low-income individuals, employees of the Commonwealth, and policeman who voluntarily subscribe to the Puerto Rico health insurance medical plan. The board of director's president is elected by the Governor and all board of director's members is executives on a trustworthy position. The Commonwealth provides financial support to PRHIA through legislative appropriations.

Puerto Rico Highway and Transportation Authority (PRHTA) – PRHTA is governed by the Secretary of DTPW. PRHTA has broad powers to carry out its responsibilities in accordance with DTPW's overall transportation policies. These powers include, among other things, the complete control and supervision of any highway facilities constructed, owned, or operated by PRHTA, the ability to set tolls for the use of the highway facilities, and the power to issue bonds, notes, or other obligations. PRHTA plans and manages the construction of all major projects relating to the Commonwealth toll highway system, undertakes major repairs, and maintains the toll ways. The Commonwealth has the ability to significantly influence rates charged by PRHTA.

Puerto Rico Infrastructure Financing Authority (PRIFA) – PRIFA is governed by the board of directors of GDB and the Secretary of the Treasury of the Commonwealth. Its responsibilities are to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other component units and governmental instrumentalities of the Commonwealth, which are authorized to develop infrastructure facilities and to establish alternate means for financing them. PRIFA's Board of directors members are executives on a trustworthy position, named and supervise by the Governor. The Commonwealth provides financial support to PRIFA through legislative appropriations.

University of Puerto Rico (UPR) – UPR is governed by a thirteen-member board of trustees comprised of one full-time student, two permanent professors, and ten community citizens of the private sector, of which at least one must be graduated from the institution. Community citizens are designated by the Governor with the advice and consent of the Senate. Members designated by the Governor are appointed for a period of four to eight years. The terms for the student and professors are of one year. The Commonwealth provides financial support to UPR through legislative appropriations.

Nonmajor Component Units

Agricultural Services and Development Administration (ASDA) – ASDA is governed by the Secretary of Agriculture of the Commonwealth. The purpose of ASDA is to provide a wide variety

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

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of services and incentives to the agricultural sector. Therefore, the government has the ability impose its will. The Commonwealth provides financial support to ASDA through legislative appropriations.

Automobile Accidents Compensations Administration (AACA) – AACA is governed by a four-member board appointed by the Governor with the advice and consent of the Senate. AACA operates a system of compulsory insurance coverage for all registered motor vehicles and compensates citizens for injuries arising from motor vehicle accidents. The Commonwealth has the ability to significantly influence rates charged by AACA.

Cardiovascular Center Corporation of Puerto Rico and the Caribbean (CCCPRC) – CCCPRC is governed by a five-member board comprised of the Secretary of Health of the Commonwealth, the Director of the Medical Sciences Campus of the UPR, the Executive Director of the Puerto Rico Medical Services Administration, and two additional members appointed by the Governor with the consent of the Senate, one of which should be from the Cardiology Society of Puerto Rico and another a member of a cardiology foundation properly registered in the Department of State of the Commonwealth. The purpose of the CCCPRC is to provide special treatment to patients suffering from cardiovascular diseases. The Commonwealth provides financial support to CCCPRC through legislative appropriations.

Caribbean Basin Projects Financing Authority (CBPFA) – CBPFA is governed by a seven-member board comprised by the Secretary of State of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company (PRIDCO), the President of GDB, the President of the Economic Development Bank for Puerto Rico, and three citizens, including at least two from the private sector, appointed by the Governor with the advice and consent of the Senate. CBPFA is authorized to issue revenue bonds and to lend the proceeds thereof to finance projects for the development of the Caribbean Basin countries that were authorized to receive investments of funds under the provisions of Section 936 of the U.S. Internal Revenue Code. The Commonwealth has access to CBPFA's resources.

Corporation for the Development of the Arts, Sciences, and Film Industry of Puerto Rico (CDASFIPR) – CDASFIPR is governed by a seven-member board of directors comprised by the Secretary of the Economic Development and Commerce of the Commonwealth, the Chairman of the Board of the Puerto Rico Public Broadcasting Corporation, the Secretary of the Treasury of the Commonwealth, the Executive Director of the Institute of Puerto Rican Culture (IPRC), and three private citizens, appointed by the Governor with the advice and consent of the Senate. At least two of these private citizens must have proven interest, knowledge, and experience in arts, sciences, and the film industry. CDASFIR was created with the purpose of developing the production of local films in Puerto Rico. The Commonwealth provides financial support to CDASFIR through legislative appropriations.

Economic Development Bank for Puerto Rico (EDB) – EDB is governed by a nine-member board comprised of the President of GDB, who is the Chairman, the Secretary of Agriculture of the Commonwealth, the Secretary of the Department of Economic Development and Commerce of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of the Tourism Company of Puerto Rico, and four other members representing the private sector and appointed by the Governor with the consent of the Senate. Private sector

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members are appointed for a period of three years. The government has the ability to impose its will on this component unit. EDB is responsible for the promotion and development of the private sector economy of the Commonwealth. This purpose is to be met by granting direct loans, loan guarantees, and or direct investments to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises with preference but not limited to economic activities that may have the effect of substituting imports.

Employment and Training Enterprises Corporation (ETEC) – ETEC is governed by a ten-member board comprised of the Puerto Rico Corrections Administrator, the Administrator of Youth Correctional Institutions, the Secretary of Justice of the Commonwealth, the Secretary of Education of the Commonwealth, the Executive Director of the Right to Employment Administration, the Administrator of the Administration of Mental Health and Anti-Addiction Services, the Sub-Administrator for the Promotion of Puerto Rico Industries of the Economic Development Administration, the Director of the Volunteer Corps, and two private citizens appointed by the Governor with the consent of the Senate. The purpose of ETEC is to provide training, management, development, and employment for inmates of the correctional institutions of the Commonwealth. The Commonwealth provides financial support to ETEC through legislative appropriations.

Farm Insurance Corporation of Puerto Rico (FICPR) – FICPR is governed by a five-member board consisting of the Secretary of Agriculture of the Commonwealth, the Dean of the Agricultural Sciences Faculty of the UPR Mayagüez Campus, a representative of GDB, and two bona fide farmers appointed by the Governor with the consent of the Senate. The purpose of the FICPR is to provide insurance to farmers against losses in their farms caused by natural disasters.

Fine Arts Center Corporation (FACC) – FACC is governed by the board of directors of the *IPRC*. FACC was created with the purpose of administering the Fine Arts Center. The Commonwealth provides financial support to FACC through legislative appropriations.

Governing Board of the 9-1-1 Service (911 Service) – The Governing Board of 911 Service (the Board) is comprised of the Commissioner of Security and Public Protection, the Executive Director of the Medical Emergency Services, the Director of the State Emergency Management Agency, the Chief of the Puerto Rico Firefighters Corps, and one member appointed by consensus of the four ex-official members to represent the public interest. The 911 Service is responsible for providing an efficient service of fast response to emergency calls through the 911 number and transferring these to the appropriate response agencies using technological and human resources to safeguard lives and properties. The Commonwealth has access to 911 Service's resources.

Institutional Trust of the National Guard of Puerto Rico (ITNGPR) – ITNGPR is governed by a seven-member board comprised of the National Guard Special Assistant, the President of GDB, the Secretary of Justice of the Commonwealth, three militaries from the Puerto Rico National Guard, and one representative from the community recommended by the National Guard Special Assistant and appointed by the Governor. ITNGPR's purpose is to provide life insurance, retirement benefits, and economic assistance to the active members of the Puerto Rico National Guard and their families. The Commonwealth provides financial support to ITNGPR through legislative appropriations.

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Musical Arts Corporation (MAC) – MAC is governed by a seven-member board appointed by the Governor with the consent of the Senate including the president of the board of IPRC. MAC was created to promote the development of the arts and cultural programs of the Commonwealth. The Commonwealth provides financial support to MAC through legislative appropriations.

National Parks Company of Puerto Rico (NPCPR) – NPCPR is governed by a nine-member board comprised of the Secretary of Recreation and Sports of the Commonwealth (the Secretary), who is the chairman, the Secretary of Education of the Commonwealth, the Executive Director of the Tourism Company of Puerto Rico (TCPR), the Secretary of Natural and Environmental Resources of the Commonwealth, and five members appointed by the Governor with the recommendation from the Secretary and with known interest in the development and preservation of parks in the private sector. NPCPR is responsible for the operation of all national parks and the protection, conservation, and use of parks, beaches, forests, and natural and historical monuments for the optimum enjoyment of present and future generations. The Commonwealth provides financial support to NPCPR through legislative appropriations.

Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives (PCSDIPRC) – PCSDIPRC is governed by a nine-member board consisting of the Administrator of the Cooperative Development Administration, the Commissioner of Financial Institutions of Puerto Rico (the Commissioner of Financial Institutions), the Commissioner of Insurance of Puerto Rico, the Secretary of the Treasury of the Commonwealth, the Inspector of Cooperatives, four citizens representing the cooperative movement, and one private citizen representing the public interest. PCSDIPRC has the responsibility of providing to all the cooperatives and the Federation of Cooperatives of Puerto Rico, insurance coverage over the stocks and deposits, for monitoring the financial condition of the insured cooperatives, and of uninsured cooperatives when requested by the Commissioner of Financial Institutions.

Puerto Rico Conservatory of Music Corporation (PRCMC) – PRCMC is governed by a seven-member board appointed by the Governor. PRCMC is responsible for providing the Puerto Rican community and especially its youths with the required facilities to educate and perfect their musical skills, including secondary education programs for developing musical arts. It prepares the artistic element that nourishes the Puerto Rico Symphony Orchestra and other musical organizations, and coordinates the governmental efforts to interested industries, private enterprises, and particular citizens. The Commonwealth provides financial support to PRCMC through legislative appropriations.

Puerto Rico Convention Center District Authority (PRCCDA) – PRCCDA is governed by a board comprised of nine members, three of which shall be from the public sector and six from the private sector. The public sector members are comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Executive Director of the Tourism Company of Puerto Rico, and the Mayor of the Municipality of San Juan. The private sector members are individuals having experience in the areas of hospitality, tourism, real estate, or convention centers who are appointed by the Governor with the advice and consent of the Senate. PRCCDA was created to develop, own, finance, plan, design, construct, operate, manage, and promote the new Puerto Rico Convention Center, currently under development. The Commonwealth provides financial support to PRCCDA through legislative appropriations.

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Puerto Rico Council on Higher Education (PRCHE) – PRCHE is governed by a board comprised of eight members appointed by the Governor with the advice and consent of the Senate and the Secretary of Education of the Commonwealth as an ex-officio member. Its purpose is to develop higher education, to administer the licensing and certification of institutions of higher education, and to administer scholarship funds. The Commonwealth provides financial support to PRCHE through legislative appropriations.

Puerto Rico Government Investment Trust Fund (PRGITF) – PRGITF is governed by the Secretary of the Treasury of the Commonwealth. GDB is its trustee, custodian, and administrator. PRGITF's main objective is to provide investment opportunities in a professionally managed money market portfolio by investing, in high quality securities, with minimal credit risk. Qualified investors include the Commonwealth's central government, its public corporations, instrumentalities and agencies, and the municipalities of Puerto Rico. In conformity with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*, the financial statements of the PRGITF are not included in the accompanying basic financial statements because the primary government and each component unit investor is already presenting as cash or investment their corresponding share of the assets of the PRGITF (see note 5).

Puerto Rico Industrial Development Company (PRIDCO) – PRIDCO is governed by a seven-member board comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Secretary of the Treasury of the Commonwealth, the President of GDB, the President of the Planning Board of Puerto Rico, and three members from the private sector appointed by the Governor with the advice and consent of the Senate. The private sector members are appointed for a period of four years. PRIDCO administers the Commonwealth-sponsored economic development program by providing facilities, general assistance, and special incentive grants to manufacturing companies operating in Puerto Rico. PRIDCO has issued interim notes and revenue bonds to finance manufacturing plants and other facilities. Rentals derived from the leasing of specified facilities of PRIDCO are pledged for the payment of PRIDCO's revenue bonds. PRIDCO maintains debt that is paid with Commonwealth appropriations.

Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (known as AFICA by its Spanish acronym) – AFICA is governed by a seven-member board consisting of the Secretary of Economic Development and Commerce, the President of GDB, the Executive Director of PRIFA, the Executive Director of the Tourism Company of Puerto Rico, the President of the Environmental Quality Board, and two private citizens appointed by the Governor. AFICA is authorized to issue revenue bonds to finance industrial, tourist, environmental control, medical, and educational facilities in Puerto Rico and the United States for use by private companies, nonprofit entities, or governmental agencies. The bonds are payable solely from collections from such private companies, nonprofit entities, or governmental agencies, and do not constitute debt of the Commonwealth or any of its other component units. The Commonwealth has access to AFICA's resources. AFICA maintains debt that is paid with Commonwealth appropriations.

Puerto Rico Land Administration (Land Administration) – The Land Administration is governed by an eleven-member board comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who serves as president, the Secretary of the Treasury of the Commonwealth,

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the Secretary of Agriculture of the Commonwealth, the Secretary of DTPW of the Commonwealth, the Secretary of Housing of the Commonwealth, the Executive Director of PRIDCO, the President of the Planning Board of Puerto Rico, and four other members appointed by the Governor with the advice and consent of the Senate. The Land Administration acquires parcels of land on behalf of government instrumentalities through negotiation or expropriation. The Commonwealth provides financial support to the Land Administration through legislative appropriations.

Puerto Rico Land Authority (Land Authority) – The Land Authority is governed by a five-member board consisting of the Secretary of Agriculture of the Commonwealth and four members appointed by the Governor. The Land Authority was created to carry out the provisions of the Land Law of Puerto Rico. The Land Authority maintains debt that is paid with Commonwealth appropriations.

Puerto Rico Maritime Transportation Authority (PRMTA) – PRMTA is under the control of the Secretary of DTPW of the Commonwealth. Its purpose is to administer and operate the maritime transportation services (ferries operations). The Commonwealth provides financial support to PRMTA through legislative appropriations.

Puerto Rico Medical Services Administration (PRMSA) – PRMSA is governed by a ten-member board comprised of the Secretary of Health of the Commonwealth, who is the Chairman, the Dean of the Medical Sciences Faculty of the UPR, the President of the Board of the Puerto Rican Cancer Society, the Mayor of the Municipality San Juan, the Administrator of the State Insurance Fund Corporation (SIFC), the Secretary of the Department of Family Affairs of the Commonwealth, the Administrator of the Administration of Mental Health and Anti-Addiction Services, the President of the Medical Policy and Administration Committee, and two consumers appointed by the Secretary of Health of the Commonwealth. Its purpose is to plan, organize, operate, and administer the centralized health services, provided in support of the hospital and other functions, offered by the member institutions and users of the medical complex known as the Puerto Rico Medical Center. The Commonwealth provides financial support to PRMSA through legislative appropriations.

Puerto Rico Metropolitan Bus Authority (PRMBA) – PRMBA is governed by the Secretary of DTPW of the Commonwealth. PRMBA provides bus transportation to passengers within the San Juan Metropolitan Area. The Commonwealth provides financial support to PRMBA through legislative appropriations.

Puerto Rico Municipal Finance Agency (PRMFA) – PRMFA is governed by a five-member board comprised of the President of GDB, who is the Chairman, the Commissioner of Municipal Affairs, and three additional members appointed by the Governor, one of whom shall be either the mayor or chief financial officer of a municipality. PRMFA was organized to create a capital market to assist the municipalities of Puerto Rico in financing their public improvement programs.

Puerto Rico Ports Authority (PRPA) – PRPA is governed by a five-member board consisting of the Secretary of DTPW of the Commonwealth, who is the Chairman, the Secretary of Economic Development and Commerce of the Commonwealth, the Economic Development Administrator, the Executive Director of the Tourism Company of Puerto Rico, and one private citizen appointed for a period of four years by the Governor with the advice and consent of the Senate. The purpose of PRPA is to administer all ports and aviation transportation facilities of the Commonwealth and to

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render other related services. The Commonwealth provides financial support to PRPA through legislative appropriations.

Puerto Rico Public Broadcasting Corporation (PRPBC) – PRPBC is governed by an eleven-member board of directors comprised of the Secretary of Education of the Commonwealth, the President of the UPR, the Executive Director of IPRC, and eight private citizens, appointed by the Governor with the advice and consent of the Senate. At least three of these private citizens must have proven interest, knowledge, and experience in education, culture, art, science, or radio and television. PRPBC was created for the purpose of integrating, developing, and operating the radio, television, and electronic communication facilities that belongs to the Commonwealth. The Commonwealth provides financial support to PRPBC through legislative appropriations.

Puerto Rico School of Plastic Arts (PRSPA) – PRSPA is governed by a seven-member board. Four members are appointed by the board of directors of IPRC, representing the public educational and cultural interests. Board members may not be employees of the PRSPA. The remaining three members are elected from among the members of the board of directors of IPRC, one of whom will serve as president. PRSPA was created to develop, promote, plan, and coordinate programs of study in higher education oriented to the plastic arts, teaching, artistic techniques, and to help students to develop humanistic values. The Commonwealth provides financial support to PRSPA through legislative appropriations.

Puerto Rico Solid Waste Authority (PRSWA) – PRSWA is governed by a four-member board comprised of the Secretary of the Department of Natural and Environmental Resources (DNER) of the Commonwealth, the Executive Director of PRSWA, the Special Assistant to the Secretary of DNER and one other board member appointed by the Governor with the advice and consent of the Senate. PRSWA provides alternatives for processing of solid waste and encourages recycling, reuse, and recovery of resources from waste. The Commonwealth provides financial support to PRSWA through legislative appropriations.

Puerto Rico Telephone Authority (PRTA) – PRTA is governed by a five-member board comprised of the President of GDB and four members that are appointed by the board of directors of GDB. PRTA is the legal entity responsible to account for the equity interest in Telecomunicaciones de Puerto Rico, Inc. for the benefit of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities. The Commonwealth provides financial support to PRTA through legislature appropriations.

Puerto Rico Trade and Export Company (PRTEC) – PRTEC is governed by the Secretary of Economic Development and Commerce of the Commonwealth. PRTEC has the responsibility to promote the highest efficiency in the services provided to the commercial sector, with emphasis on small and medium-sized enterprises while promoting the export of products and services from the Puerto Rico to other countries. The Commonwealth provides financial support to PRTEC through legislative appropriations.

Right to Employment Administration (REA) – REA is governed by an administrator appointed by the Governor with the consent of the Senate. In addition, a consultative board comprised of the Secretary of Labor and Human Resources of the Commonwealth, the Secretary of Agriculture of the

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Commonwealth, the Secretary of the DTPW of the Commonwealth, the Secretary of Education of the Commonwealth, and five additional members appointed by the Governor, with the consent of the Senate, will advise the administrator on the implementation of the Right to Employment Act. The Commonwealth provides financial support to REA through legislative appropriations.

Special Communities Perpetual Trust (SCPT) – SCPT is governed by a board of directors composed of seven members: the Secretary of Housing of the Commonwealth, the Secretary of the DTPW of the Commonwealth, the Coordinator for the Social and Economic Financing of the Special Communities, one mayor of a municipality of Puerto Rico, one community leader resident in one special community and two private citizens representing the public interest. All members of the board of directors are appointed by the Governor. SCPT's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. The Commonwealth provides financial support to SCPT through legislative appropriations.

State Insurance Fund Corporation (SIFC) – SIFC is governed by a seven-member board appointed by the Governor with the advice and consent of the Senate. The board is comprised by the Commissioner of Insurance of Puerto Rico, an officer from the Department of Labor and Human Resources of the Commonwealth, an officer from the Department of Health of the Commonwealth, a representative of the employer's interest, a representative of the employees' interest, and two members without any of these interests. One of these members is appointed by the Governor as president of the board for a period of six years. The three public officials are appointed for a period of five years, and the rest of the members for four, three, two, and one year, respectively. SIFC provides workers' compensation and disability insurance to public and private employees. The Commonwealth has access to SIFC's resources. Payments made by SIFC to the Commonwealth during the year ended June 30, 2005 amounted to approximately \$33 million.

Tourism Company of Puerto Rico (TCPR) – TCPR is governed by a seven-member board comprised of representatives of different tourist-related sectors appointed by the Governor with the consent of the Senate. At least one member must represent internal tourism and two must not be residents of the metropolitan area. Its purpose is to promote the tourism industry of Puerto Rico. The Commonwealth provides financial support to TCPR through legislative appropriations.

Complete financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Government Development Bank for Puerto Rico
P.O. Box 42001
San Juan, PR 00940-2001

Puerto Rico Aqueduct and Sewer Authority
P.O. Box 7066
San Juan, PR 00916-7066

Puerto Rico Electric Power Authority
P.O. Box 364267
San Juan, PR 00936-4267

Puerto Rico Health Insurance Administration
P.O. Box 195661
San Juan PR 00919-5661

Puerto Rico Highway and Transportation Authority
P.O. Box 42007
San Juan, PR 00940-2007

Puerto Rico Infrastructure Financing Authority
Capital Center 235
Ave. Arterial Hostos, Suite 1601
San Juan, PR 00918-433

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University of Puerto Rico
Jardín Botánico Sur 1187
Calle Flamboyán
San Juan, PR 00926-1117

Automobile Accident Compensation
Administration
P.O. Box 364847
San Juan, PR 00936-4847

Caribbean Basin Projects Financing
Authority
P.O. Box 42001
San Juan, PR 00940-2001

Economic Development Bank for Puerto Rico
P.O. Box 2134
San Juan, PR 00922-2134

Farm Insurance Corporation of Puerto Rico
P.O. Box 9200
San Juan, PR 00908

Governing Board of the 9-1-1 Service
P.O. Box 270200
San Juan, PR 00927-0200

Musical Arts Corporation
P.O. Box 41227 – Minillas Station
San Juan, PR 00940-1227

Public Corporation for the Supervision and
Deposit Insurance of Puerto Rico Cooperatives
P.O. Box 195449
San Juan, PR 00919-5449

Puerto Rico Convention Center District Authority
P.O. Box 19269
San Juan, P.R 00910-1269

Puerto Rico Government Investment Trust Fund
P.O. Box 42001 – Minillas Station
San Juan, PR 00940-2001

Agricultural Services and Development
Administration
P.O. Box 9200
San Juan, PR 00908-0202

Cardiovascular Center Corporation of Puerto Rico
and the Caribbean
P.O. Box 366528
San Juan, PR 00936-6528

Corporation for the Development of the Arts,
Sciences, and Film Industry of Puerto Rico
P.O. Box 362350
San Juan, PR 00936-2350

Employment and Training Enterprises
Corporation
P.O. Box 366505
San Juan, PR 00936-6505

Fine Arts Center Corporation
P.O. Box 41287 – Minillas Station
Santurce, PR 00940-1287

Institutional Trust of the National Guard of Puerto
Rico
P.O. Box 9023786
San Juan, PR 00902-3786

National Parks Company of Puerto Rico
P.O. Box 9022089
San Juan, PR 00902-2089

Puerto Rico Conservatory of Music Corporation
350 Lamar Street and Roosevelt Avenue
San Juan, PR 00918-2199

Puerto Rico Council on Higher Education
P.O. Box 19900
San Juan, PR 00910-1900

Puerto Rico Industrial Development Company
P.O. Box 362350
San Juan, PR 00936-2350

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Puerto Rico Industrial, Tourist, Educational,
Medical, and Environmental Control Facilities
Financing Authority
P.O. Box 42001
Minillas Station San Juan, PR 00940-2001

Puerto Rico Land Authority
P.O. Box 9745
San Juan, PR 00908-9745

Puerto Rico Medical Services Administration
P.O. Box 2129
San Juan, PR 00922-2129

Puerto Rico Municipal Finance Agency
235 Arterial Hostos Avenue
Suite 1601, Capital Center II
San Juan, PR 00918-1433

Puerto Rico Ports Authority
P.O. Box 362829
San Juan, PR 00936-2829

Puerto Rico School of Plastic Arts
P.O. Box 9021112
San Juan, PR 00902-1112

Puerto Rico Telephone Authority
P.O. Box 42001
San Juan, PR 00940-2001

Right to Employment Administration
P.O. Box 364452
San Juan, PR 00936-4452

Tourism Company of Puerto Rico
P.O. Box 902-3960
Old San Juan Station
San Juan, PR 00902-3960

Puerto Rico Land Administration
P.O. Box 363767
San Juan, PR 00936-3767

Puerto Rico Maritime Transportation Authority
P.O. Box 362829
San Juan, PR 00936-2829

Puerto Rico Metropolitan Bus Authority
P.O. Box 195349
San Juan, PR 00919-5349

Puerto Rico Public Broadcasting Corporation
P.O. Box 19-0909
San Juan, PR 00919-0909

Puerto Rico Solid Waste Authority
P.O. Box 40285 – Minillas Station
San Juan, PR 00940-0285

Puerto Rico Trade and Export Company
P.O. Box 195009
San Juan, PR 00919-5009

Special Communities Perpetual Trust
635 Fernandez Juncos Avenue
San Juan, PR 00907

State Insurance Fund Corporation
P.O. Box 365028
San Juan, PR 00936-5028

The financial statements of the discretely presented component units have a year-end of June 30, 2005, except for the Puerto Rico Telephone Authority, which has a year-end of December 31, 2004.

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Fiduciary Component Units

The three employee retirement systems administer pension funds for the Commonwealth and its political subdivisions. The three systems are subject to legislative and executive controls, and the administrative expenses are subject to legislative budget controls. These component units, while meeting the definition of a component unit and are legally separate, are presented in the fund financial statements along with other fiduciary funds of the Commonwealth. They have been omitted from the government-wide financial statements.

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) – ERS is governed by a board of trustees, which is composed of the Secretary of the Treasury of the Commonwealth, who is the President, the President of GDB, the Commissioner for Municipal Affairs, the Director of the Puerto Rico Central Office of Personnel Administration, two participating employees, and one retiree, who are appointed by the Governor. The Commonwealth reports ERS as a single-employer pension plan. ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their own retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution plan (System 2000) for employees hired by the government on or after January 1, 2000.

Puerto Rico Judiciary Retirement System (JRS) – JRS is governed by the same board of trustees as ERS. JRS is a single-employer defined-benefit plan, administered by ERS, which covers all individuals holding a position as Justice of the Supreme Court, Judge of the Superior Court or the District Court, or Municipal Judges of the Commonwealth.

Puerto Rico System of Annuities and Pensions for Teachers (TRS) – TRS is governed by a nine-member board comprised of the Secretary of Education of the Commonwealth, the Secretary of the Treasury of the Commonwealth, the President of GDB, two active teachers (one of them is a representative of the teachers organization according to Act No. 45 of February 1998), two retired teachers, one representative of the teachers organizations and one representative of the public interest appointed by the Governor with the advice and consent of the Senate for four years. The Commonwealth reports TRS as a single-employer pension plan. TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers, all teachers transferred to an administrative position in the Department of Education of the Commonwealth, teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of the Commonwealth. TRS provides retirement, death, and disability benefits.

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Complete financial statements of these component units can be obtained directly by contacting their respective administrative offices at:

Employees' Retirement System of the
Government of Puerto Rico and its
Instrumentalities
P.O. Box 42003 – Minillas Station
Santurce, PR 00940

Puerto Rico Judiciary Retirement System
P.O. Box 42003 – Minillas Station
Santurce, PR 00940

Puerto Rico System of Annuities and Pensions for
Teachers
P.O. Box 191879
San Juan, PR 00919-1879

(c) *Government-wide Financial Statements*

The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the nonfiduciary activities of the Commonwealth and its component units. For the most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component units for which the primary government is financially accountable. The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ***Invested in Capital Assets, Net of Related Debt*** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- ***Restricted Net Assets*** – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- ***Unrestricted Net Assets*** – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Commonwealth's policy to use restricted resources first, then the unrestricted resources as they are needed.

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The statement of activities demonstrates the degree to which the direct expenses of a given function, segment, or component unit are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. Program revenue includes charges to customers who purchase, use, or directly benefit from goods or services provided by a given function, segment, or component unit. Program revenue also includes grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items not properly included among program revenue are reported instead as general revenue. Resources that are dedicated internally are reported as general revenue rather than as program revenue. The Commonwealth does not allocate general government (indirect) expenses to other functions.

(d) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

Government-wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Commonwealth considers most revenue to be available if collected within 120 days after the end of the current fiscal year-end. Principal revenue sources considered susceptible to accrual include tax revenue, net of estimated overpayments (refunds) and amounts considered not collectible, which are recorded as taxpayers earn income (income taxes), as sales are made (consumption and use taxes), and as cash is received (miscellaneous taxes). In applying the susceptible to accrual concept to federal grants, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the Commonwealth on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employees' vested annual vacation and sick leave are recorded as an expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2005 have been reported only in the government-wide financial statements.
- Interest and principal on general long-term obligations are recorded when due, except for interest and principal due in July 1 of the following fiscal year.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.

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- Debt service expenditures, federal funds cost disallowances, other long-term obligations, and amounts subject to judgments under litigation are recorded only when payment is due.

Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements – The financial statements of the proprietary funds fiduciary, funds and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each enterprise fund has the option under GASB Statement No. 20 to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The primary government's major enterprise funds have elected not to apply FASB pronouncements issued after November 30, 1989 and two nonmajor enterprise funds elected to adopt the FASB's pronouncements issued after November 30, 1989. Also, certain discretely presented component units have disclosed their election in their separately issued financial statements. The component units follow U.S. GAAP as issued by GASB and FASB as applicable to each component unit based on the nature of their operations. In addition, the Puerto Rico Government Investment Trust Fund adopted GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*; however, such financial statements are not included in the accompanying basic financial statements because the primary government and each component units investor already present their corresponding share of the assets of the PRGITF as cash or investments.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The major operating revenue of the Commonwealth enterprise funds is as follows:

- **Unemployment Insurance Trust Fund** – Amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.
- **Lotteries Fund** – Amounts collected from the sale of traditional lottery tickets and electronic lotto games.

(e) ***Fund Accounting***

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities, and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of the assets, liabilities, revenue, or expenditures/expenses of either the fund category or the governmental and enterprise funds combined. The nonmajor funds are combined in a single column in the fund financial statements. The Commonwealth reports the following major funds:

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Governmental Funds

General Fund – The general fund is the primary operating fund of the Commonwealth. It is used to account for all financial transactions, except those required to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, and education.

Debt Service Fund – The debt service fund accounts for the accumulation of resources predominantly for, and the payment of, general long-term bonds' principal, interest and related costs other than bonds payable from the operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following fiscal year are accounted for as a fund liability if resources are available as of June 30 for its payment.

Public Buildings Authority Capital Projects Fund – The Public Buildings Authority's capital projects fund is used to account for the financial resources used for the acquisition or construction of major capital facilities not financed by proprietary fund types, pension trust funds, and discretely presented component units.

The Children's Trust Special Revenue Fund – The Children's Trust special revenue fund is used to account for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico.

Proprietary Funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

Unemployment Insurance Trust Fund – This fund accounts for amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.

Lotteries Fund – This fund accounts for the assets and operations of two lottery systems administered by the Commonwealth.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Commonwealth's fiduciary funds:

Pension Trust Funds – These are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees' retirement systems.

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Agency Funds – These are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

Discretely Presented Component Units

Discrete presentation of component units is used to present the financial information of entities that do not qualify to be blended, in accordance with GASB No. 14, with the funds of the primary government. The component units column in the government-wide financial statements is used to report the financial activities of the Commonwealth's discretely presented component units. The financial statements of these component units are presented following the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

(f) Statutory (Budgetary) Accounting

The Commonwealth's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received, net of tax refunds claimed by taxpayers as of year-end. Short- and long-term borrowings may be used to finance budgetary excess of expenditures over revenue. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Encumbrances lapse the year following the end of the fiscal year when the encumbrance was established, as established by Act No. 123 of August 17, 2001, which amended the then existing appropriations and encumbrances lapsing provisions of Act No. 230 of July 23, 1974. Unencumbered appropriations lapse at year-end. Amounts required for settling claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

Under the statutory basis of accounting, the Commonwealth uses encumbrance accounting to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

The statement of revenue and expenditures – budget and actual – budget basis – general fund, only presents the information for the general fund for which there is a legally adopted budget, as required by GAAP. See note 3 for a reconciliation of the statement of revenue and expenditures – budget and actual – budget basis – general fund with the statement of revenue, expenditures, and changes in fund balance (deficit) for the general fund.

(g) Cash and Short-Term Investments

The Commonwealth follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements, and any excess is invested in various interest-bearing accounts with GDB and with the PRGITF. At June 30, 2005, excess of checks drawn over the pooled bank balance amounted to approximately \$581 million and is reported within accounts payable and accrued liabilities of the governmental activities.

Cash and cash equivalents include investments with original maturities of 90 days or less for the purpose of reporting enterprise fund cash flows.

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The Commissioner of Financial Institutions requires that private financial institutions deposit collateral securities to secure the deposits of the Commonwealth and all other governmental entities in each of these institutions. The amount of collateral securities to be pledged for the security of public deposits shall be established by rules and regulations promulgated by the Commissioner of Financial Institutions.

The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit with the U.S. Treasury. Interest earned over such deposit is retained in the fund.

Cash and short-term investments and cash equivalents of the component units are maintained in separate bank accounts, from those of the primary government, in their own names.

(h) *Securities Purchased Under Agreements to Resell*

Certain component units of the Commonwealth enter into purchases of securities with simultaneous agreements to resell. The amounts advanced under these agreements generally represent short-term loans and are reflected as an asset. The securities underlying these agreements mainly consist of U.S. government obligations, mortgage-backed securities, and interest-bearing deposits with other banks.

(i) *Securities Lending Transactions*

Certain component units of the Commonwealth enter into securities lending transactions in which governmental entities (lenders) transfer their securities to broker-dealers and other entities (borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Securities received as collateral are generally reflected as investments with a corresponding liability resulting from the obligation to return such collateral.

(j) *Investments*

Investments include U.S. government and agencies obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, investment contracts, and corporate debt and equity obligations. Investment securities, including investments in limited partnership, are presented at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts, which are presented at cost. Changes in the fair value of investments are presented as investment earnings in the statement of activities, the statement of revenue, expenditures, and changes in fund balance – governmental funds, and the statement of revenue, expenses, and changes in fund net assets – proprietary funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

The PRGITF is considered a 2a7-like external investment pool and, as such, reports its investments at amortized cost.

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The reverse repurchase agreements reported by certain discretely presented component units are authorized transactions under their respective enabling legislation and authorized by GDB.

(k) Receivables

Tax receivables in the general fund include predominantly amounts owed by taxpayers for individual and corporate income taxes, net of estimated uncollectible amounts. A portion of these income tax receivables is recognized as revenue when they become measurable and available based on actual collections during the 120 days following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers on income earned in periods prior to June 30, 2005, estimated to be collectible but not currently available, and thus are reported as deferred revenue in the general fund. Unemployment, disability, and driver's insurance receivable in the enterprise funds are stated net of estimated allowances for uncollectible accounts.

Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables primarily represent amounts owed to the Commonwealth for reimbursement of expenditures incurred pursuant to federally funded programs. Intergovernmental receivables also include taxes that the Municipal Revenue Collection Center (CRIM, as per its Spanish acronym), a municipal corporation, is required to remit to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. The amount to be remitted is based on the special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, which is levied by the CRIM [see note 14(c)].

The accounts receivable from nongovernmental customers of the component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the primary government and other component units that arise from service charges do not have allowances for uncollectible accounts, as these are deemed fully collectible.

Loans of the general fund represent predominantly amounts owed by public corporations and municipalities for public insurance and rent paid by the general fund on their behalf.

The loans of the pension trust funds do not have allowances for uncollectible amounts since such loans are secured by mortgage deeds, plan members' contributions, and any unrestricted amounts remaining in escrow. Loans of the component units consist predominantly of loans to the primary government, other component units and municipalities, and do not have allowances for uncollectible accounts as those are deemed fully collectible. The remaining loans of the component units are to small and medium businesses, agricultural, and low-income housing loans from nongovernmental customers, and are presented net of estimated losses on such portfolios.

(l) Inventories

Generally, inventories are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories are recorded as expenditures when purchased rather than capitalized as an asset. Only significant amounts of inventory at the end of the year are capitalized in the

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governmental funds. However, inventories are always capitalized in the statement of net assets of governmental activities.

(m) *Restricted Assets*

Funds set aside for the payment and guarantee of notes and interest payable and for other specified purposes are classified as restricted assets since their use is limited for this purpose by applicable agreements or required by law. Restricted assets in the proprietary funds mainly include amounts set aside for the payment of insurance benefits.

(n) *Real Estate Held for Sale*

Real estate held for sale are stated at their estimated net realizable value determined by management based on previous units sales, commitments, or appraisal values.

(o) *Capital Assets*

Capital assets, which include land, buildings, building improvements, equipment, vehicles, construction in process, and infrastructure assets are reported in the applicable governmental, business-type activities and component unit columns in the government-wide financial statements. The Commonwealth's primary government defines capital assets as assets, which have an initial, individual cost of \$25,000 or more at the date of acquisition and have a useful life of five or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available.

The method to deflate the current cost of the same or a similar asset using an approximate price index was used to estimate the historical cost of certain land, buildings, and building improvements because invoices and similar documentation was no longer available in certain instances. Donated capital assets are recorded at fair market value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during construction period only for business-type activities and most component units. The costs of normal maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, provides transition standards that make available an extended period of deferral (fiscal year 2006) before the requirement to record and depreciate general infrastructure assets acquired before implementation date (July 1, 2001) becomes effective. General infrastructure assets acquired prior to July 1, 2001 were recorded during the fiscal year ended June 30, 2005.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the primary government are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. The estimated useful life of capital assets is as follows:

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	<u>Years</u>
Buildings and buildings improvements	20 – 50
Equipment, furniture, fixtures, and vehicles	5 – 15
Infrastructure	50

The capital assets of the component units are recorded in accordance with the applicable standards of the component units and under their own individual capitalization thresholds. Depreciation has been recorded when required by these standards based on the types of assets, use and estimated useful lives of the respective assets, and on the nature of each of the component unit's operations.

The estimated useful lives of capital assets reported by the component units are as follows:

	<u>Years</u>
Buildings and buildings improvements	3 – 50
Equipment, furniture, fixtures, and vehicles	3 – 20
Infrastructure	10 – 50

(p) Tax Refunds Payable

During the calendar year, the Commonwealth collects individual income taxes through withholdings and payments from taxpayers. At June 30, the Commonwealth estimates the amount owed to taxpayers for overpayments during the first half of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

(q) Deferred Revenue

Deferred revenue at the governmental fund level arises when potential revenue does not meet neither the "measurable" or the "available" criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Commonwealth has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Commonwealth has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and the revenue is recognized. Deferred revenue at the government-wide and proprietary fund levels arises only when the Commonwealth receives resources before it has a legal claim to them.

(r) Long-Term Debt

The liabilities reported in the government-wide financial statements include Commonwealth general obligation bonds and long-term notes, obligations under lease/purchase agreements, and long-term liabilities including vacation, sick leave, long-term liabilities to other governmental entities, net pension obligation, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Long-term obligations financed by proprietary fund types and component units are recorded as liabilities in those funds and in the discretely presented component unit's column.

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Premiums, Discounts, and Issuance Costs – In the government-wide financial statements, long-term debt and other long-term obligations are presented in the columns for governmental and business-type activities. The same is presented in the proprietary fund financial statements. Bond and note premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the debt. Bonds and notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges in other assets and are amortized over the term of the related debt. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

(s) *Reservations of Fund Balance – Governmental Funds*

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Reserves for encumbrances, debt service, and other specific purposes are examples of the latter.

(t) *Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*, the Commonwealth's financial reporting entity is considered to be a sponsor of three single-employer defined-benefit pension plans: ERS, JRS, and the TRS. This is because substantially all the participants in the three pension trust funds are part of the financial reporting entity of the Commonwealth. For the purpose of the basic financial statements, and as disclosed in note 19, the Commonwealth's annual pension cost, measured on the accrual basis of accounting, for the year ended June 30, 2005 amounted to approximately \$882 million. However, the amount recognized as pension expenditure in the governmental funds was recorded under the modified accrual basis, and amounted to approximately \$578 million. The excess of the annual required contribution over the statutorily required contributions increased the net pension obligation at June 30, 2005 to approximately \$4.5 billion. This amount is presented in the statement of net assets of the governmental activities as of June 30, 2005.

For purposes of the stand-alone financial statements of each of the blended and discretely presented component units, the entities accounted for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized are equal to the statutorily or contractually required contributions, with a liability recorded for any unpaid required contributions. The basis of accounting used by the component units was either modified accrual basis or accrual basis, depending upon individual fund structure and type of entity. Most component units did not have pension-related assets or liabilities at transition because they have contributed the statutorily required contributions.

(u) *Postemployment Benefits*

In addition to the pension benefits described in note 19, the Commonwealth provides postemployment healthcare benefits and a Christmas bonus for its retired employees in accordance

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with local law. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree with the Commonwealth providing a matching share of not more than \$100 per month for each retiree. During the year ended June 30, 2005, the cost of providing healthcare benefits amounted to approximately \$144 million for approximately 120,412 retirees. The Christmas bonus paid to these retired employees during the year ended June 30, 2005 was \$400 per retiree and the total amount was approximately \$48.2 million. These benefits are recorded as expenditures when paid in the general fund.

(v) ***Compensated Absences***

The vacation policy of the Commonwealth generally provides for the accumulation of 2.5 days per month, except for the teachers who accrue 4 days per month. Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of 60 days. Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated unpaid leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated absences of the primary government at June 30, 2005 amounting to approximately \$1.5 billion is presented in the statement of net assets. Compensated absence accumulation policies for the blended component units and component units vary from entity to entity based on negotiated agreements and other factors agreed upon between the management of these entities and their employees.

The Public Service Personnel Law requires certain component units and the primary government of the Commonwealth to annually pay the employees the accumulated vacation and sick leave earned in excess of the limits mentioned above.

(w) ***Interfund and Intraentity Transactions***

The Commonwealth has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

Intraentity Transactions – There are two types of intraentity transactions. First, are resource flows between the primary government and its component units and among the component units. These resource flows and related outstanding balances are reported as if they were external transactions. However, resource flows between the primary government and blended component units are classified as interfund transactions, as described above. Second, are intraentity balances between the primary government funds and discretely presented component units that are tantamount to long-term debt financing. The primary government's liability is reported in the statement of net assets, the proceeds in the primary government's funds, and the asset in the discretely presented component units' statement of net assets.

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(x) ***Lottery Revenue and Prizes***

The revenue, expenses, and prizes awarded by the Lottery of Puerto Rico and the Additional Lottery System, reported within the lotteries enterprise fund, are recognized as drawings are held. Moneys collected prior to June 30 for tickets related to drawings to be conducted subsequent to June 30 are reported as deferred revenue. Unpaid prizes awarded as of June 30 are reported as a fund liability.

(y) ***Risk Management***

The Commonwealth purchases commercial insurance covering casualty, theft, tort claims, and other losses for the primary government, most component units, and the municipalities. The Commonwealth is reimbursed for premium payments made on behalf of the component units and the municipalities. The current insurance policies have not been canceled or terminated. For workers' compensation, the Commonwealth has a discretely presented component unit, the SIFC, which provides workers' compensation to both public and private employees. In the past three years, the Commonwealth has not settled claims that exceed insurance coverage.

Certain component units combine commercial insurance with internal self-insurance funds covering specific risks related to their specialized operations.

(z) ***GASB Technical Bulletin No. 2004-1***

The Children's Trust (the Trust) follows the GASB Technical Bulletin No. 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issue (the TB), which provides accounting guidance for entities created to obtain the rights to all or a portion of suture tobacco settlement resources and for the governments that create such entities.

The TB indicates that the entity created to obtain the rights, which is called the Tobacco Settlement Authority (TSA), should be considered a component unit of the government that created it and the component unit should be blended. The TB also states that the government receiving the payments from the tobacco companies under the Agreement, which are called settling governments, should recognize a receivable and revenue for tobacco settlement resources (TSRs) when an event occurs. The event that results in the recognition of an asset and revenue by settling government is the domestic shipment cigarettes. The TB indicates that accruals should be made by the settling government and TSAs for estimates for estimated shipments from January 1 to their respective fiscal year-ends, since the annual payments are based on a calendar year. However, under the modified-accrual basis of accounting at the fund level, revenue should be recognize only to the extent that resources are available.

(aa) ***Reclassifications***

Certain reclassifications have been made to the information presented in the separately issued financial statements of certain blended component units and agencies included within the special revenue, debt service, capital projects, enterprise funds and discretely presented component units to conform to the accounting classifications used by the Commonwealth in the basic financial statements.

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(bb) Use of Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(cc) Future Adoption of Accounting Pronouncements

The GASB has issued the following accounting standards that have effective dates after June 30, 2005:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 43, *Financial Reporting for Post employment Benefit Plans Other Than Pension Plans*, which is effective for fiscal years beginning after December 15, 2004.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section—an amendment of NCGA Statement 1*, which is effective for statistical sections prepared for periods beginning after June 15, 2005.
- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which is effective for fiscal years beginning after December 15, 2006.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*, which is effective for fiscal years, beginning after June 15, 2005.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which is effective for periods beginning after June 15, 2005.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pensions and Other Postemployment Benefit Expenditures/Expense and Liability by Cost-Sharing Employers*. As it relates to pension transactions, this Technical Bulletin is effective for financial statements for periods ending after December 15, 2004. As it relates to OPEB transaction, it is effective for financial statements for periods beginning after December 15, 2006. The effect of this Technical Bulletin on the accompanying basic financial statements was not considered material as it relates to pension transactions.

The impact of these statements on the Commonwealth's basic financial statements has not yet been determined.

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(2) Component Units

The Commonwealth follows the provisions of GASB No. 14. The basic financial statements of the Commonwealth include the financial statements of the following component units that were audited by other auditors:

Blended component units:

- Public Buildings Authority
- Puerto Rico Maritime Shipping Authority
- The Children's Trust

Discretely presented component units:

- Agricultural Services and Development Administration
- Automobile Accident Compensation Administration
- Cardiovascular Center Corporation of Puerto Rico and the Caribbean
- Caribbean Basin Projects Financing Authority
- Corporation for the Development of the Arts, Sciences, and Film Industry of Puerto Rico
- Economic Development Bank for Puerto Rico
- Employment and Training Enterprises Corporation
- Farm Insurance Corporation of Puerto Rico
- Fine Arts Center Corporation
- Governing Board of the 9-1-1 Service
- Government Development Bank for Puerto Rico
- Institutional Trust of the National Guard of Puerto Rico
- Musical Arts Corporation
- National Parks Company of Puerto Rico
- Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives
- Puerto Rico Aqueduct and Sewer Authority
- Puerto Rico Conservatory of Music Corporation
- Puerto Rico Convention Center District Authority
- Puerto Rico Council on Higher Education
- Puerto Rico Electric Power Authority
- Puerto Rico Government Investment Trust Fund
- Puerto Rico Industrial Development Company
- Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority
- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Health Insurance Administration
- Puerto Rico Highway and Transportation Authority
- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Industrial, Tourist, Educational, Medical, Environmental Control Facilities Financing Authority
- Puerto Rico Land Administration
- Puerto Rico Land Authority

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Puerto Rico Maritime Transportation Authority
Puerto Rico Medical Services Administration
Puerto Rico Metropolitan Bus Authority
Puerto Rico Municipal Finance Agency
Puerto Rico Municipal Finance Agency
Puerto Rico Ports Authority
Puerto Rico Public Broadcasting Corporation
Puerto Rico School of Plastic Arts
Puerto Rico Solid Waste Authority
Puerto Rico Trade and Export Company
Puerto Rico Telephone Authority
Right to Employment Administration
Special Communities Perpetual Trust
State Insurance Fund Corporation
Tourism Company of Puerto Rico
University of Puerto Rico

(3) Stewardship, Compliance, and Accountability

(a) *Budgetary Control*

The Governor is constitutionally required to submit to the Legislature an annual balanced budget of the Commonwealth for the ensuing fiscal year. The annual budget is prepared by the Commonwealth's OMB and takes into consideration the advice provided by the Puerto Rico Planning Board (annual economic growth forecasts, and four-year capital improvements plan), the Department of the Treasury of the Commonwealth (revenue estimates, accounting records, and the comprehensive annual financial report), GDB (fiscal agent), and other governmental offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The annual budget, which is developed utilizing elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year capital improvements plan adopted by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon approval by the Legislature, the budget is referred to the Governor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by two-thirds majority in each house, may override the Governor's veto. If a budget

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is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Governor, is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Commonwealth to continue making payments for its operating and other expenses until the new budget is approved. The appropriated annual budget for fiscal year 2005 amounted to approximately \$5.5 billion. The Legislature also made several special budgetary appropriations to the general fund throughout the year, which amounted to approximately \$3.3 billion.

The OMB has authority to amend the budget within a department, agency, or government unit without legislative approval.

For budgetary purposes, encumbrance accounting is used. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations within GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The unencumbered balance of any appropriation of the general fund at the end of the fiscal year lapses immediately. Appropriations, other than in the general fund, are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

In addition, the Legislature may direct that certain revenue be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. Appropriations are enacted for certain departments, agencies, and government units included in the balance sheet of the general fund. For these funds, a statement of revenue and expenditures – budget and actual – budget basis – general fund is included. Appropriations for capital projects are made for each bond issue and the authorization continues for the expected construction period.

The Commonwealth's Department of the Treasury and OMB have the responsibility to ensure that budgetary spending control is maintained on an individual department basis. OMB may transfer part or all of any unencumbered balance within a department to another department subject to legislative approval. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System (PRIFAS). PRIFAS ensures that encumbrances or expenditures are not processed if they exceed the department's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for general fund expenditures, principal and interest due for the year for the debt service fund, and by bond authorization for capital expenditures.

(b) Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity, timing, and basis differences in the excess (deficiency) of revenue and other

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financing sources over expenditures and other financing uses for the year ended June 30, 2005 is presented below for the general fund (expressed in thousands):

Excess of revenue and other financing sources over expenditures and other financing uses – budget basis	\$	75,222
Entity differences:		
Excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for:		
Nonbudgeted funds		(192,128)
Inclusion of agencies with independent treasuries		(54,377)
Timing differences:		
Adjustment for encumbrances		30,718
Current year expenditure against prior year encumbrances		(37,927)
Basis of accounting differences:		
Net increase in taxes receivable (net of tax refunds)		10,128
Net decrease in other receivables		32,615
Net increase in deferred revenue		<u>(11,412)</u>
Excess of expenditures and other financing uses over revenue and other financing sources (GAAP basis)	\$	<u><u>(147,161)</u></u>

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(c) *Deficit Net Assets*

The following activities, funds, and discretely presented component units reflect deficit fund balance/net assets at June 30, 2005 (expressed in thousands):

Primary government:

Governmental activities	\$ 15,916,789
General fund	\$ 511,271
Enterprise fund – lotteries	\$ 201,365

Component units:

Puerto Rico Land Authority	\$ 150,005
Agricultural Services Development Administration	\$ 89,554
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	\$ 44,386
Puerto Rico Health Insurance Administration	\$ 24,693
Puerto Rico Medical Services Administration	\$ 20,463
Employment and Training Enterprises Corporation	\$ 5,611
Right to Employment Administration	\$ 601
Musical Arts Corporation	\$ 555

The Commonwealth's governmental activities show a deficit of approximately \$16 billion, mostly attributed to long-term obligations amounting to approximately \$25 billion, which is recognized in the statement of net assets. On the other hand, the discretely presented component units report net assets of approximately \$17.8 billion. This inverse relationship between the governmental activities and component units' net assets reveal the operational structure of the Commonwealth where the primary government issues debt, the proceeds of which are predominantly transferred to the component units and to other governments as well, to finance their capital projects and other operational needs. The Commonwealth includes within the annual budgetary appropriation process the necessary funds to cover the annual debt service requirements of the aforementioned debt, most of which are the result of Act No. 164 of December 17, 2001, described in note 14(d). Also, as part of the fiscal reform referred to below, certain component units will be subject to reductions in future legislative appropriations provided by the primary government, requiring the affected component units to increase their revenue base and fee structure currently being charged to the general public.

In response to the general fund deficit, the Commonwealth has taken legislative and executive actions intended to eliminate such deficits through a comprehensive tax and fiscal spending reform. The combination of these actions, designed to increase recurring revenue and control government spending, is intended to eliminate the Commonwealth's structural budget deficit by fiscal year 2008.

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On November 21, 2005, as a result of a joint effort by the two principal political parties to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Commonwealth Legislature approved, and the Governor signed, Joint Resolution No. 321 (the Joint Resolution). On the same day, the Governor issued an Executive Order implementing the fiscal measures defined in the Joint Resolution. The Joint Resolution and the Fiscal Reform Executive Order impose government-wide expenditure controls and set forth the basic principles and parameters that will govern the reform of the Commonwealth's tax system and fiscal policy and practices. The proposed tax reform is aimed at increasing revenue by expanding the tax base through the implementation of a broad-based tax on the retail sale of articles of use and consumption.

The Joint Resolution and the Fiscal Reform Executive Order come in the wake of expenditures controls to be implemented during fiscal year 2006, which includes a reduction of appointed government positions, a limitation on the creation of new temporary employee positions, a hiring freeze, and a voluntary work week reduction program, as well as limitations on the primary government vehicle fleets and other expenses.

(4) Changes in Reporting Entity and Restatement

The following table illustrates the change to net assets at the beginning of the year as previously reported in the governmental activities' statement of net assets and to fund balances at the beginning of the year as reported in the statement of revenue, expenditures and changes in fund balances – governmental funds. The changes resulted from the effect of a correction of housing units and land lot held for resale, cash account not recorded in prior years and to correct miscellaneous accounts resulting in a net effect of \$1.8 million. In addition capital assets were increased by \$638 million, net of accumulated depreciation, to capitalize retroactively general infrastructure assets in accordance with the transition provisions of GASB Statement No. 34, Basic Financial Statement – and Management's Discussion and Analysis – for State and Local Governments as further discussed in note 12 to the basic financial statements. The beginning balances have been restated as follows (expressed in thousands):

	Net assets – governmental activities	Fund balances – general fund
Beginning balance, as previously reported	\$ (13,656,346)	(365,950)
Correction of errors	1,840	1,840
Retroactive capitalization of general infrastructure assets	638,411	—
Beginning balance, as restated	<u>\$ (13,016,095)</u>	<u>(364,110)</u>

The following table summarizes changes to net assets at the beginning of the year as previously reported in the statement of net assets by certain discretely presented component units. The changes resulted primarily from exclusions of nonmajor component units in current years' presentation, and restatements to correct errors in the prior year's financial statements of certain component units (expressed in thousands):

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Beginning net assets, as previously reported	\$ 16,182,847
Restatement of Puerto Rico Highway and Transportation Authority (a major component unit)	1,677,515
Restatements of nonmajor component units	(81,206)
Nonmajor component units excluded in fiscal year 2005, but included in fiscal year 2004	<u>(10,322)</u>
Beginning net assets, as restated	<u>\$ 17,768,834</u>

The Puerto Rico Highway and Transportation Authority has restated its financial statements to capitalize interest cost on assets, in accordance with FASB Statement No. 34, *Capitalization of Interest Cost*, and FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants, an amendment of FASB No. 34*. The portion of this restatement related to net assets not capitalized in prior years was recorded as an adjustment against the beginning balance of net assets. The net effect of the restatement was to increase 2004 capital assets and beginning balance of net assets by approximately 1.7 billion.

(5) Puerto Rico Government Investment Trust Fund (PRGITF)

PRGITF was created by Act No. 176, of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust administered by GDB that was created for the purpose of providing eligible governmental investors of Puerto Rico with a convenient and economical way to invest in a professionally managed money market portfolio. PRGITF is not an investment company or a mutual fund and is not subject to regulation or registration under the investment company Act of 1940. Units issued by PRGITF are not subject to regulation or registration under the Securities and Exchange Act of 1933, as amended, because the units are issued by a government entity. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

PRGITF is considered a 2a7-like external investment pool, and as such, reports its investment at amortized cost.

The investment securities on hand at June 30, 2005, consisted of certificates of deposit, bank notes, corporate obligations, commercial paper, and U.S. government and agencies obligations, all of which may be considered highly liquid. However, the participants' investments are subject to the ability of PRGITF to receive payment from the securities' issuer when due. The liquidity of certain investments and changes in interest rates may affect PRGITF's yield and the fair value of its investments.

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The dollar amount of the deposits on hand at June 30, 2005, at \$1.00 per unit of participation, was reported in the individual financial statements of each of the participants, and combined in the basic financial statements as follows (expressed in thousands):

	<u>Balance outstanding</u>	<u>Percentage of total</u>
Primary government:		
Commonwealth	\$ 308,453	64.74%
The Children's Trust	111,724	23.45%
Public Buildings Authority	75	0.20%
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	2	0.00%
Total for primary government	<u>420,254</u>	<u>88.39%</u>
Discretely presented component units:		
Government Development Bank for Puerto Rico	25,113	5.27%
Puerto Rico Aqueduct and Sewer Authority	24,229	5.09%
Institutional Trust of National Guard of Puerto Rico	3,373	0.71%
Puerto Rico Infrastructure Financing Authority	667	0.14%
Puerto Rico Land Administration	587	0.12%
Puerto Rico Solid Waste Authority	538	0.11%
State Insurance Fund Corporation	397	0.08%
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	233	0.05%
Puerto Rico Electric Power Authority	149	0.03%
National Parks Company of Puerto Rico	41	0.01%
	<u>55,327</u>	<u>11.61%</u>
Other governmental entities	<u>855</u>	<u>0.18%</u>
Total for all participants	<u>\$ 476,436</u>	<u>100.00%</u>

The deposits at June 30, 2005 were invested in securities with a cost which approximates fair value, plus accrued interest, for approximately \$476 million. The external portion of PRGITF was not considered significant for separate reporting in the accompanying basic financial statements.

(6) Deposits and Investments

Pursuant to the provisions of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951, as amended, the primary government may invest in different types of securities, including domestic, international and fixed income securities, among others.

For the year ended June 30, 2005, the primary government adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. The objective of this statement is to update the custodial credit risk disclosure requirements of Statement 3 and to establish more comprehensive disclosure requirements addressing other common risks of the deposits and investments of state and local governments. This statement establishes

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and modifies disclosure requirements related to investments risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. In addition, it establishes disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

The primary government maintains a cash and investment pool that is available for use by all funds, except for the fiduciary funds. Each fund's portion of this pool is reported on the statement of net assets as cash and cash equivalents. The fiduciary funds investments are held and managed separately from those of other primary government funds.

Primary Government

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

The carrying amount of deposits with financial institutions of the primary government at June 30, 2005 consists of the following (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks and U.S. Treasury	\$ 1,101,852	1,032,900	2,134,752	1,886,380
Component unit banks	675,976	908,824	1,584,800	2,307,062
Total	\$ 1,777,828	1,941,724	3,719,552	4,193,442

Custodial credit risk is the risk that in the event of bank failure, the primary government's deposit might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

At year end, the Commonwealth's bank balance of deposits in commercial banks amounting to \$1.4 million was covered by Federal depository insurance or by collateral held by the Commonwealth's agent in the Commonwealth's name. Deposits of approximately \$521 million with the U.S. Treasury represent unemployment insurance taxes collected from employers that are transferred to the Federal Unemployment Insurance Trust Fund in the U.S. Treasury. These deposits are uninsured and uncollateralized. The bank balance of deposits in component unit banks, which as of June 30, 2005, amounted to approximately \$2.3 billion are also uninsured and uncollateralized. These deposits in component unit banks are maintained with GDB and EDB. Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover these deposits.

Deposits in component unit banks represent the balance of interest and noninterest-bearing accounts in GDB and EDB. The deposit liability at GDB and EDB is substantially related to deposits from other

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component units and of the Commonwealth. The deposit liability does not agree with the governmental cash balances shown above because of reconciling items such as outstanding checks and deposits in transit. The bank balance of GDB's and EDB's deposits at June 30, 2005 is broken down as follows (expressed in thousands):

Primary government	\$ 1,851,744
Discretely presented components units	<u>1,807,980</u>
Total pertaining to the Commonwealth	3,659,724
Municipalities of Puerto Rico	507,824
Other nongovernmental entities	693,413
Certificates of indebtedness	261,056
Escrow accounts	<u>299,427</u>
Total deposits per GDB and EDB	<u>\$ 5,421,444</u>

Unrestricted deposits include approximately \$308 million that are invested in PRGITF (see note 5). Such amount has been included as cash and cash equivalents in the primary government's statement of net assets.

Investments

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the primary government may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2005 securities investments were registered in the name of the Commonwealth and were held in the possession of the Commonwealth's custodian bank.

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Primary Government

The fair value by investment type, credit quality rating and maturity of the unrestricted investments reported by the governmental activities at June 30, 2005 consist of the following (expressed in thousands):

Investment type	Fair value	Investment ratings		Investment maturity- less than 1 year
		AAA to A	Not rated	
Money market fund	\$ 696	—	696	696
PRGTF	111,724	111,724	—	111,724
State and local government securities	114	—	114	114
Guaranteed investment contract	83,683	83,683	—	83,683
Investment pool	31,060	31,060	—	31,060
Total investments	\$ 227,277	226,467	810	227,277

Business-Type Activities

The fair value by investment type, credit quality ratings and maturity of the restricted investments reported by the business-type activities at June 30, 2005 consist of the following (expressed in thousands):

Investment type	Fair value	Not rated	Maturity (in years)			
			Less than 1 year	1 to five years	6 to 10 years	More 10 years
Mortgage-backed securities	\$ 3,355	3,355	18	772	570	1,995
U.S. government and agency securities	30,585	30,585	5,941	16,065	8,579	—
Total investments	\$ 33,940	33,940	5,959	16,837	9,149	1,995

Component Units

Cash and cash equivalents of the component units at June 30, 2005 consist of following (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks	\$ 2,150,980	666,678	2,817,658	2,777,508
Component unit banks	521,629	968,898	1,490,527	1,493,934
Total	\$ 2,672,609	1,635,576	4,308,185	4,271,442

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

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Custodial credit risk is the risk that in the event of bank failure, the component unit's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's, failure, the component units may not be able to recover these deposits.

The component units were exposed to the following custodial credit risk arising from the balance of deposits maintained in commercial and component unit banks at June 30, 2005 (expressed in thousands):

Uninsured and uncollateralized	\$	3,267,233
Uninsured and collateralized with securities held by pledging financial institutions		620,394
Uninsured and collateral with securities held by the pledging financial institution but not in the component unit's name		<u>383,815</u>
Total	\$	<u><u>4,271,442</u></u>

Investments

The component units' investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico and municipalities
- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth

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- Options, futures, and interest-rates swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products which qualify under any of the foregoing investment categories
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's Investors Service
- A few component units, principally SIFC, are also allowed to enter into foreign currency investments, under certain limitations

The component units' investment policies establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into.

The component units' investment policies provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Fitch Ratings or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. Also, the investment policy specifies that no more than 5% of a manager's assets at fair value shall be invested in the securities of any single issuer.

All investments in US Treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government and are presented as "not rated" in the table below. The credit quality rating for investments held by the component units at June 30, 2005 are as follows (expressed in thousands):

	Fair value			Investment ratings		
	Unrestricted	Restricted	Total	AAA to A	BBB+	Not rated
Mortgage-backed securities	\$ 387,577	603,119	990,696	982,276	—	8,420
U.S. government and agency securities	1,116,468	2,940,581	4,057,049	3,888,121	—	168,928
Puerto Rico municipal bond and notes	—	1,234,864	1,234,864	1,234,864	—	—
Negotiable certificates of deposit	347,463	329,176	676,639	233,386	—	443,253
U.S. equity securities	524,767	13,889	538,656	38,342	27,187	473,127
Non-U.S. equity securities	31,165	1,850	33,015	—	—	33,015
US corporate debt securities	528,877	20,321	549,198	368,386	170,772	10,040
Commercial paper	15,326	—	15,326	7,948	—	7,378
Repurchase agreements	125,863	240,000	365,863	35,000	—	330,863
Foreign and municipal bonds	13,975	—	13,975	12,054	1,202	719
Money market funds	49,605	—	49,605	—	—	49,605
Guaranteed investment contracts	—	829,517	829,517	829,517	—	—
PRGITF	26,007	—	26,007	25,610	—	397
Investment pool	55,793	40,272	96,065	62,735	—	33,330
Security lending transactions	39,616	—	39,616	—	—	39,616
Investment in other equity securities	88,321	—	88,321	—	—	88,321
Non-participating contracts	348,754	785,206	1,133,960	761,846	218,873	153,241
Other	26,202	921	27,123	23,702	—	3,421
Total investments	\$ 3,725,779	7,039,716	10,765,495	8,503,787	418,034	1,843,674

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Certain component units classified approximately \$29 million of investment presented in PRGITF as cash and cash equivalents.

The following table summarizes the type and maturities of investments held by the component units at June 30, 2005 (expressed in thousands):

	Fair value	Maturity (in years)				No stated maturity date
		Less than 1 year	1 to 5 years	6 to 10 years	More than 10 years	
Mortgage-backed securities	\$ 990,696	8,843	70,563	53,150	858,140	—
U.S. government and agency securities	4,057,049	390,787	1,672,659	182,618	1,810,985	—
Puerto Rico municipal bonds and notes	1,234,864	92,686	316,130	385,782	440,266	—
Negotiable certificates of deposit	676,639	675,639	1,000	—	—	—
U.S. equity securities	538,656	—	—	—	74,575	464,081
Non-U.S. equity securities	33,015	—	1,850	—	22,640	8,525
U.S. corporate debt securities	549,198	31,684	316,789	120,150	80,575	—
Commercial paper	15,326	2,307	9,715	1,829	1,475	—
Repurchase agreements	365,863	365,863	—	—	—	—
Foreign and municipal bonds	13,975	1,178	5,480	223	7,094	—
Money market funds	49,605	49,605	—	—	—	—
Guaranteed investment contracts	829,517	125,777	363,762	—	339,978	—
PRGITF	26,007	26,007	—	—	—	—
Investment pool	96,065	93,015	—	—	—	3,050
Security lending transactions	39,616	18,331	4,037	17,248	—	—
Investment in other equity securities	88,321	—	—	—	—	88,321
Non-participating contracts	1,133,960	615,012	135,946	2	359,062	23,938
Other	27,123	22,729	973	—	1,700	1,721
Total	\$ 10,765,495	2,519,463	2,898,904	761,002	3,996,490	589,636

Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The component units were exposed to the following custodial credit risk for investments held at June 30, 2005 (expressed in thousands):

Insured or registered	\$ 9,312,724
Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the component unit's name	6,600
Uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in the component unit's name	1,446,171
	<u>\$ 10,765,495</u>

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Foreign Currency risk

SIFC limits its exposure to foreign currency risk by limiting the total amount invested to 5% of the total investment balance. The SIFC investments in foreign currency is as follows (expressed in thousands):

Investment type	Local currency	Fair value at U.S. currency
Money market funds	Hong Kong Dollar	\$ 52
Equity securities	Australian Dollar	1,327
	British Pound	15,070
	Canadian Dollar	2,628
	Danish Krone	1,809
	Euro	22,656
	Hong Kong Dollar	1,236
	Japanese Yen	15,280
	Norwegian Krone	1,195
	Swedish Krone	955
	Swiss Franc	7,027
		\$ 69,183

GDB's policy establishes that the Asset Liability Management Committee (ALCO) is responsible for implementing and monitoring the Bank's interest risk policies and strategies. The ALCO meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and liabilities

Unrestricted repurchase agreements of approximately \$35 million and \$91 million belong to EDB and SIFC, respectively, and the restricted amounts of \$240 million belong to GDB. As of June 30, 2005, the fair value of the collateral for the repurchase agreements amounted to approximately \$31 million for EDB, which consisted primarily of investment securities held in custody by EDB's agent, and \$91 million for SIFC, which consisted primarily of investment securities held by SIFC's agent but not in SIFC's name.

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Fiduciary Funds

Cash and cash equivalents of the fiduciary funds at June 30, 2005 consist of the following (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks	\$ 561,336	4,448	565,784	565,784
Component unit banks	142,910	1,578	144,488	39,914
Total	\$ 704,246	6,026	710,272	605,698

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

Custodial Risk

Custodial credit risk is the risk that, in the event of a bank failure, the fiduciary funds' deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in component unit banks are exempt from the collateral requirement established by the Commonwealth and thus represents a custodial credit risk because in the event of the component unit bank's failure, the Commonwealth may not be able to recover these deposits.

As of June 30, 2005, \$25.3 million was exposed to custodial credit risk. Cash exposed to foreign currency risk as of June 30, 2005 are as follows (expressed in thousands):

Investment type	Currency	Fair value at	
		U.S. dollar currency	
Foreign Currency	Pound Sterling	\$	2,202
Foreign Currency	Japanese Yen		168
Foreign Currency	Euro		151
Foreign Currency	New Turkish Lira		1
		\$	2,522

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Investments

The investment policies of the pension trust funds limit the investment in corporate debt securities to the top rating issued by nationally recognized credit rating organizations. The portfolio is expected to maintain a minimum weighted average credit quality of either "A" or better using either Standard and Poor's or Moody's credit ratings. The following table summarizes the fair value by investment type and maturities of investments held by the pension trust funds at June 30, 2005 (expressed in thousands):

Investments type	Maturity (in years)					Total
	Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years	No stated maturity	
Non-U.S. securities and other investments \$	—	—	—	—	541,114	541,114
U.S. equity securities	—	—	—	—	1,591,430	1,591,430
U.S. government and agencies securities	135,566	74,417	11,269	23,751	—	245,003
Mortgage-backed securities	9,793	1,295	—	—	—	11,088
U.S. mutual funds	—	—	—	—	604,725	604,725
Negotiable certificates of deposit	1,807	—	—	—	—	1,807
Non-U.S. mutual funds	—	—	—	—	345,391	345,391
Money market funds	5,424	—	—	—	—	5,424
U.S. corporate debt securities	112	93,317	62,227	40,638	—	196,294
Limited partnership/private equity	—	—	—	—	85,991	85,991
Investment in PRTA Holdings	—	—	—	—	486,080	486,080
Total	\$ 152,702	169,029	73,496	64,389	3,654,731	4,114,347

Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table summarizes the credit quality ratings for investments held by the pension trust funds at June 30, 2005 (expressed in thousands):

Investments type	Fair value	Rating			
		AAA to A	BBB+	C+	Not Rated
Non-U.S. equity securities	\$ 541,114	541,114	—	—	—
U.S. equity securities	1,591,430	1,591,430	—	—	—
U.S. government and agencies securities	245,003	242,994	—	45	1,964
Mortgage-backed securities	11,088	11,088	—	—	—
U.S. mutual funds	604,725	604,725	—	—	—
Negotiable certificates of deposits	1,807	1,807	—	—	—
Non-U.S. mutual funds	345,391	345,391	—	—	—
Money markets funds	5,424	5,424	—	—	—
U.S. corporate bonds	196,294	140,042	56,252	—	—
Limited partnership/private equity	85,991	—	—	—	85,991
Investment in PRTA Holdings	486,080	—	—	—	486,080
Total	\$ 4,114,347	3,484,015	56,252	45	574,035

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As of June 30, 2005 the investments of the pension trust funds were exposed to custodial credit risk as follows (expressed in thousands):

Uninsured and unregistered investments held by the governmental entity's agent in the name of the Commonwealth.	\$	1,435,963
Uninsured or unregistered investments not held in the name of the Commonwealth, but held by the counterparty's trust department, or the counterparty's agent but not held in the Commonwealth's name		102,106
	\$	<u>1,538,069</u>

At June 30, 2005, securities investments amounting to \$2,090,198 were registered in the name of the TRS and were held in the possession of the TRS's custodian bank. Additionally, securities investments amounting to \$486,080 were registered in the name of the ERS and held in its possession.

The investment in non-U.S. stocks is expected to achieve long-term, aggressive capital appreciation by investing in Core EAFE (Europe Australasia and the Far East) securities. The portfolio is expected to be broadly diversified with respect to exposures to countries, economic sectors, industries and individual stock. No single issue is expected to exceed 5% (at market) of the portfolio.

Investments exposed to foreign currency risk as of June 30, 2005 are as follows:

<u>Investment type</u>	<u>Currency</u>	<u>Fair value at U.S. dollar currency</u>
Equity securities	Euro	\$ 176,834
Equity securities	Pound Sterling	116,440
Equity securities	Japanese Yen	111,008
Equity securities	Swedish Krona	35,366
Equity securities	Swiss Franc	24,215
Equity securities	Australian Dollar	23,007
Equity securities	Hong Kong Dollar	19,307
Equity securities	Danish Krone	12,803
Mutual funds	Pound Sterling	6,172
Depository receipts	Euro	5,298
Equity securities	South African Rand	4,289
Equity securities	Singapore Dollar	4,207
Equity securities	New Zealand Dollar	2,168
		<u>\$ 541,114</u>

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(7) Securities Lending Transactions

During the year, the ERS and the JRS, included within the fiduciary funds, and SIFC and AACA, two discretely presented component units, entered into securities lending transactions. These transactions are explained below:

Primary Government

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities and Puerto Rico Judiciary Retirement System (the Retirement Systems)

The Retirement Systems' securities custodian, as agent for the Retirement Systems, manages the securities lending program and receives liquid collateral. The collateral requirement is equal to 102% for securities issued in the United States and 105% for securities issued outside of the United States of the fair value of the securities lent. Securities lending obligations for which collateral was received as of June 30, 2005 consist of the following (expressed in thousands):

Securities lent	Fair value of underlying securities
U.S. corporate debt securities	\$ 548
U.S. equity securities	65,791
	<u>\$ 66,339</u>

The collateral received amounted to approximately \$69 million. The collateral securities cannot be pledged or sold unless the borrower defaults, therefore, these transactions are not reported as assets and liabilities in the statements of fiduciary net assets. Collateral received was invested as follows: \$20 million in commercial paper, \$7 million in reverse repurchase agreement U.S. agency delivered, and \$42 million in reverse purchase agreement mortgage-backed tri-party. The relationship between the investment maturities and the Retirement Systems' loans cannot be determined.

At year-end, the Retirement Systems have no credit risk exposure to borrowers because the amounts the Retirement Systems owe the borrowers exceed the amounts the borrowers owe to the Retirement Systems. The Retirement Systems' rights to collateral are defined in the contractual agreements. The borrower's creditworthiness is also proactively reviewed by the lending agent.

Component Units

SIFC

The Commonwealth statutes and the SIFC's board of directors' policies permit SIFC to use its investments to enter into securities lending transactions. The SIFC's securities custodian, as agent of SIFC, manages the securities lending program and receives cash, securities, or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by SIFC unless the borrower defaults. The collateral requirement is equal to 102% for securities issued in the United States and 105% for securities

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issued outside of the United States of the fair value of the securities lent. Additional collateral has to be provided by the next business day if its value falls to less than 100% of the fair value of the securities lent. At year-end, SIFC has no credit risk exposure to borrowers because the amounts SIFC owes the borrowers exceed the amounts the borrowers owe SIFC. Contracts with the lending agents require them to indemnify SIFC if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay SIFC for income distributions by the securities' issuers while the securities are on loan.

All security loans can be terminated on demand by either SIFC or the borrower, although the average term of the loans is two weeks. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment of the cash collateral. Such matching existed at year-end. Securities lending obligations for which cash was received as collateral as of June 30, 2005 consist of the following (expressed in thousands):

Securities lent	Fair value of underlying securities
Equity securities	\$ 19,222
U.S. government, agencies, instrumentalities obligations	65,851
Corporate bonds and notes	25,356
	<u>\$ 110,429</u>

Cash collateral received amounted to \$113 million and it was invested as follows: \$91 million in repurchase agreements, \$20 million in money market fund, and \$2 million in U.S. governmental obligations. These secured lending activities are included in the accompanying statement of net assets, since cash was received as collateral but reinvested as explained above.

In addition, SIFC had the following securities lending obligations collateralized by securities as of June 30, 2005 (expressed in thousands):

Securities lent	Fair value of underlying securities	Securities collateral received
U.S. government, agencies, instrumentalities obligations	\$ <u>94,165</u>	<u>96,048</u>

These securities lending transactions collateralized by securities that cannot be pledged or sold unless the borrower defaults, therefore, are not reported as assets and liabilities in the accompanying balance sheets.

AACA

AACA lends securities to broker/dealers and other entities (borrowers) for collateral that will be returned in the future for the same securities. The custodial bank manages the securities lending program and receives cash, government securities, and letters of credit as collateral. The program provides for an initial

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minimum collateralization of 102% of the market value of the securities lent plus accrued income. Additional collateral has to be provided by the close of the next business day if its value falls to less than 100%. The contract with the custodial bank requires that should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency should be allocated pro rata among all client lenders within the program.

Either the custodian bank or the borrower can terminate all security loans at any time. Cash collateral is invested in the program's agent short-term investment pools, which at fiscal year-end had a weighted average maturity of approximately 30 days. The relationship between securities of the investment pool and AACA loans cannot be determined.

The following represents the balances relating to the securities lending transactions as of June 30, 2005 (expressed in thousands):

Securities lent	Fair value of underlying securities	Cash collateral received	Non-cash collateral received
U.S. Treasury bills, bonds, and notes	\$ 15,928	18,831	404
U.S. equity securities	18,736	4,724	136
U.S. corporate debt securities	4,732	15,027	1,248
U.S. agencies obligations	5,343	1,034	4,449
Totals	\$ 44,739	39,616	6,237

Secured lending transactions where cash collateral was received and reinvested are presented as assets and liabilities in the accompanying statement of net assets.

Securities lending transactions collateralized by non-cash collateral that cannot be pledged or sold unless the borrower defaults are not reported as assets and liabilities in the statement of net assets.

At year-end, AACA has no credit risk exposure to borrowers because the amounts AACA owes the borrowers exceed the amounts the borrowers owe AACA.

(8) Investments in Limited Partnerships

Pursuant to the Statement of Investment Guidelines for the Government of Puerto Rico, the pension trust funds and a component unit invested approximately \$11.5 million in limited partnerships during the fiscal year ended June 30, 2005. The investments were as follows:

- \$4 million were invested in Guayacán Fund of Funds II, L.P., a Delaware limited partnership, organized by Grupo Guayacán as general partner, that has total commitments of \$62 million of which \$50 million are from the pension trust funds and the remaining balance from the private corporate investors in Puerto Rico. The fund invests in a broad range of United States and international private equity investment partnerships that, in turn, will make equity and equity-related investments primarily in private businesses.

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- \$752,295 was invested in Invesco Venture Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the System has a total commitment of \$6 million. The Partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily United States and international funds that focus on both early-and later-stage venture capital investments.
- \$4.2 million was invested in Chase Capital Partners Private Equity Fund of Funds II, LTD, a limited partnership, organized by Chase as General Partner in which the pension trust funds have has a total commitment of \$35 million. The Fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investments opportunities across various sectors, including buyouts, growth equity, venture capital and other special situations through partnership, investments, and direct investments.
- \$2.5 million was invested in other funds in which the pension trust fund has a total commitment of \$2.5. The investment in other funds represents mainly in a hotel resort that filed Chapter 11 under the United States Bankruptcy Code.
- There were no contributions made during fiscal year 2005 in Guayacán Funds of Funds, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner that has total commitments of \$55.5 million of which \$ 45 million are from pension trust funds and the remaining from the private corporate investors. This fund invests in United States and international private equity partnerships that in turn invest in private companies.
- There were no contributions made during fiscal year 2005 in Guayacán Private Equity Fund, L.P., a Delaware limited partnership, organized by Advent/Morro Partners as general partner, that has total commitments of \$42 million of which \$10 million are from the pension trust funds, \$20 million are from a component unit and the remaining balance from the private corporate investors in Puerto Rico. This fund invests in Puerto Rico private equity.
- There were no contributions made during fiscal year 2005 in Invesco Non-U.S. Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner, in which the pension trust funds have a total commitment of \$4.5 million. The Partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily investments focusing on non-U.S. buyouts, expansion capital, turnaround, mezzanine, and distressed investment partnership.
- There were no contributions made during fiscal year 2005 in Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the pension trust funds have a total commitment of \$4.5 million. The Partnership was organized to invest in other collective funds investing in alternative assets, including primarily investments focusing on small, mid-size and large domestic buyout transactions.

The fair value of these investments at June 30, 2005 amounted to \$85.9 million and is presented within investments in the statement of net assets. The allocations of net gain and net loss to the limited partners are based on certain percentages, as established in the limited partnership agreements.

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Notes to Basic Financial Statements

June 30, 2005

As of June 30, 2005, the pension trust funds and a discretely presented component unit had capital commitments and contributions as follows (expressed in thousands):

	<u>Public sector commitments</u>	<u>Fiscal year contributions</u>	<u>Cumulative contributions</u>
Guayacán Funds of Funds, L.P.			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	\$ 25,000	—	23,279
Puerto Rico System of Annuities and Pensions for Teachers	20,000	—	18,623
Subtotal	<u>45,000</u>	<u>—</u>	<u>41,902</u>
Guayacán Fund of Funds II, L.P.			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	25,000	1,976	19,640
Puerto Rico System of Annuities and Pensions for Teachers	25,000	1,976	19,639
Subtotal	<u>50,000</u>	<u>3,952</u>	<u>39,279</u>
Guayacán Private Equity Fund, L.P.			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	5,000	—	3,930
Puerto Rico System of Annuities and Pensions for Teachers	5,000	—	3,930
Component unit – GDB	20,000	—	15,718
Subtotal	<u>30,000</u>	<u>—</u>	<u>23,578</u>
Other Funds			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	22,596	5,207	17,636
Puerto Rico System of Annuities and Pensions for Teachers	30,000	2,355	20,575
Subtotal	<u>52,596</u>	<u>7,562</u>	<u>38,211</u>
Total	<u>\$ 177,596</u>	<u>11,514</u>	<u>142,970</u>

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

(9) Receivables and Payables

Receivables in the governmental funds include approximately \$1.1 billion of accrued income and excise taxes and \$182 million receivable from the federal government and \$17 million from the Municipal Revenue Collection Center. In addition, the enterprise funds include \$61 million of unemployment, disability, and drivers' insurance premium receivable.

Payables in the governmental funds include approximately \$800 million of trade accounts due to suppliers for purchase of merchandise and services rendered and \$201 million of tax refunds liability.

In accordance with GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue* (the TB), a receivable of \$35 million, was recorded in the government-wide financial statements for estimated shipments from January 1 to June 30, 2005, which will be applied to debt service upon collection. Additionally, the TB indicated that the TSA should recognize a liability for the bonds payable and an expense (and liability if unpaid) in the same period in its stand-alone financial statements. The expense (and liability if unpaid) recognizes the contractual obligation to remit the proceeds of the bond sold. Since the TSA should be reported as a blended component unit, the TB indicates these remittances should be reported as transfers into the fund receiving the proceeds and transfers out in the fund that accounts for the activities of the TSA. Since the Trust has no contractual obligation, under its enabling legislation or elsewhere, to remit all bond proceeds or assets related to GSA to the settling government (the Commonwealth), the Trusts has not recognized an expense and liability for unpaid proceeds from the bonds since it records the expense as amounts are disbursed as grants to its settling government (including its instrumentalities) or third parties.

(10) Interfund and Intraentity Transactions

Interfund receivables and payables at June 30, 2005 are summarized as follows (expressed in thousands):

Receivable fund	Payable fund	Amount
Nonmajor governmental fund	General fund	\$ 116,672
Lotteries' fund	General fund	48,026
General fund	Lotteries' fund	54,797
General fund	Unemployment insurance	5,789
		<u>\$ 225,284</u>

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Notes to Basic Financial Statements

June 30, 2005

Transfers from/to other funds for the year ended June 30, 2005 are summarized as follows (expressed in thousands):

<u>Transferee fund</u>	<u>Transferor fund</u>	<u>Amount</u>
General fund	Other governmental funds	\$ 123,615
General fund	Unemployment insurance fund	323,310
General fund	Lotteries' fund	368,869
General fund	The Children's Trust special revenue fund	236,060
Other governmental fund	General fund	305,607
Unemployment insurance fund	General fund	197,967
Other proprietary funds	General fund	1,436
Debt service fund	General fund	377,384
The Children's Trust special revenue fund	Other governmental funds	403
PBA capital projects fund	General fund	10,744
		<u>\$ 1,945,395</u>

The principal purposes of the interfund transfers are to:

- Distribute the increase in net assets of the lotteries fund for the use of the general fund, as required by the lotteries enabling legislation.
- Make funds available for debt service payments in both the debt service fund and the general fund.
- Unemployment insurance trust fund's distribution of surplus cash belonging to the general fund for the payment of administrative expenses.
- Recognize as transfers the rental payments made by the Commonwealth's agencies on properties leased by the nonmajor funds of the PBA, a blended component unit of the Commonwealth.
- On July 29, 2004, the Commonwealth approved Act No. 171. Through Act No. 171, the Additional Lottery was required to transfer to the general fund the total amount of investments held at June 30, 2004, which resulted in a payment of \$200 million to the Commonwealth.
- Transfer of \$236 million from the Children's Trust to the general fund in order to provide financial assistance to carry out project aimed at promoting the well-being of children and youth of Puerto Rico.
- Transfer of \$403,488 from the Tobacco Settlement Asset-Backed Bonds debt service fund to the general fund in order to provide funds for operating expenses.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers.

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Notes to Basic Financial Statements

June 30, 2005

Due from/to primary government and component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Business-type activities	\$ 155,493	Puerto Rico Aqueduct and Sewer Authority	\$ 155,493
		Cardiovascular Center Corporation of Puerto Rico and the Caribbean	37,899
		Puerto Rico Health Insurance Administration	25,800
		Puerto Rico Medical Services Administration	13,428
		Tourism Company of Puerto Rico	10,730
		Employment and Trainings Enterprises Corporation	7,108
Governmental activities	99,999	Governing Board of the 9-1-1 Service	5,034
	\$ 255,492		\$ 255,492
University of Puerto Rico	\$ 119,257	Governmental activities	\$ 230,910
Puerto Rico Electric Power Authority	49,408		
Puerto Rico Medical Services Administration	24,404		
Government Development Bank for Puerto Rico	13,050		
Puerto Rico Conservatory of Music Corporation	11,885		
Puerto Rico Land Authority	5,537		
Automobile Accident Compensation Administration	3,756		
Right to Employment Administration	3,613		
	\$ 230,910		\$ 230,910

The amount owed by PRASA of \$155 million represents construction loans granted by the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, nonmajor enterprise funds, to finance the construction of capital assets for PRASA.

The amount receivable by PREPA from the primary government includes approximately \$25 million representing an agreement with the Commonwealth by which the Commonwealth will pay the outstanding fuel adjustment subsidy receivable and approximately \$24 million refinancing of other accumulated debt of the Commonwealth. The amount owed by the Commonwealth is presented within notes payable in the statement of net assets of the governmental activities.

The amount receivable by the UPR from the primary government includes a resolution approved by the Legislature of the Commonwealth to pay \$94.7 million to the UPR on behalf of the Department of Health of the Commonwealth over eight years, including the financing of additional debts of approximately \$71.2 million. The related outstanding balance of \$87.1 million is presented by the Commonwealth within notes payable in the statement of net assets of the governmental activities.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

Due from/to component units are as follows (expressed in thousands):

Receivable entity	Amount	Payable entity	Amount
University of Puerto Rico	\$ 15,645	Puerto Rico Medical Services	
Puerto Rico Electric Power Authority	16,716	Administration	\$ 32,361
Economic Development Bank for Puerto Rico	8,719	Puerto Rico Trade and Export Company	8,719
Puerto Rico Ports Authority	27,090	Puerto Rico Maritime Transportation Authority	27,090
Farm Insurance Corporation of Puerto Rico	6,913	Agricultural Services and Development Administration	17,413
Puerto Rico Land Authority	16,931	Farm Insurance Corporation of Puerto Rico	6,431
		Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities	
Puerto Rico Convention Center District Authority	1,000	Financing Authority	1,000
State Insurance Fund Corporation	3,500	Puerto Rico Solid Waste Authority	3,500
		Puerto Rico Industrial Development Company	
Puerto Rico Land Administration	<u>6,528</u>		<u>6,528</u>
Balance carried forward	\$ <u>103,042</u>		\$ <u>103,042</u>

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

<u>Receivable entity</u>	<u>Amount</u>	<u>Payable entity</u>	<u>Amount</u>
Balance carried forward	\$ 103,042		\$ 103,042
Government Development Bank for Puerto Rico	\$ 2,159,424	Puerto Rico Ports Authority	\$ 306,850
		Puerto Rico Convention Center District Authority	434,402
		Puerto Rico Highway and Transportation Authority	274,999
		University of Puerto Rico	64,963
		Special Communities Perpetual Trust	425,107
		Puerto Rico Aqueduct and Sewer Authority	303,870
		Puerto Rico Land Authority	43,270
		Puerto Rico Electric Power Authority	112,661
		Puerto Rico Metropolitan Bus Authority	25,966
		Puerto Rico Infrastructure Financing Authority	9,511
		Economic Development Bank for Puerto Rico	12,520
		National Parks Company of Puerto Rico	6,831
		Employment and Training Enterprises Corporation	662
		Puerto Rico Solid Waste Authority	70,434
		Agricultural Services and Development Administration	67,000
			<u>2,159,046</u>
	<u>\$ 2,262,466</u>		<u>\$ 2,262,088</u>

The difference amounting to \$378 thousands between due from/to component units resulted from the time lag between the dates that transactions are recorded by each discretely presented component unit and other reconciling items. The balances due to GDB amounting to approximately \$2.2 billion represent loans payable to GDB at June 30, 2005.

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Notes to Basic Financial Statements

June 30, 2005

The rest of the loans receivable reported by GDB consists of the following (expressed in thousands):

Primary government:	
Governmental activities	\$ 2,058,033
Business-type activities	520
Pension trust funds	4
	<hr/>
	2,058,557
Other governmental entities and municipalities	1,023,241
Private sector (net of \$16,904 presented within restricted assets)	407,690
	<hr/>
Total loans receivable reported by GDB	\$ 3,489,488
	<hr/>

The loans to the primary government are presented by the Commonwealth within notes payable in the statement of net assets and in the statement of fiduciary net assets. A difference of \$142 thousand resulted from the time lag between the dates that transactions are recorded by GDB and the primary government.

Expenses of the primary government include approximately \$2.6 billion in capital and operational contributions made by the primary government to the component units, comprised of the following (expressed in thousands):

Puerto Rico Health Insurance Administration	\$ 1,024,097
Puerto Rico Infrastructure Financing Authority	73,700
Puerto Rico Aqueduct and Sewer Authority	180,244
Government Development Bank for Puerto Rico	119,728
University of Puerto Rico	808,893
Nonmajor component units	438,434
	<hr/>
Total contributions made by primary government to component units	\$ 2,645,096
	<hr/>

(11) Restricted Assets

Restricted assets of the primary government included in the basic financial statements at June 30, 2005 consist of cash, investments, and other assets to be used for the following purposes (expressed in thousands):

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Notes to Basic Financial Statements

June 30, 2005

Debt service and sinking fund requirements	\$	882,868
Public Housing Administration-funds received from HUD		656,853
Construction fund		193,084
Emergency fund		100,000
Assets held in trust for repayment of Qualified Zone Academic Bonds		49,768
Investment held for disability insurance benefits		33,940
Administrative costs for unemployment insurance		31,450
Construction of governmental agencies		12,731
Residual receipts from sale of properties		11,087
Other		3,883
Total for primary government	\$	<u>1,975,664</u>

Liabilities of the primary government payable from restricted assets consist of the following (expressed in thousands):

Governmental activities:		
Tax revenue anticipation notes payable	\$	800,000
Bonds payable		633,245
Qualified Zone Academic Bonds		49,768
Deferred revenue		31,450
Interest payable		19,533
Liabilities payable from restricted assets – governmental activities	\$	<u>1,533,996</u>
Business-type activities:		
Disability insurance benefit payable		896
Liabilities payable from restricted assets – business-type activities	\$	<u>896</u>
Governmental activities: Restricted net assets		
Restricted for capital projects	\$	229,423
Restricted for debt service		63,335
Other purposes		191,681
Total restricted net assets	\$	<u>484,439</u>

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Notes to Basic Financial Statements

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Restricted assets of the component units included in the basic financial statements at June 30, 2005 are to be used for the following purposes (expressed in thousands):

Debt service and sinking fund requirements	\$ 7,052,456
Construction and betterments funds	1,109,699
Financial assistance programs	246,715
Incentives to farmers	118,696
Self-insurance fund	63,442
Maintenance reserve fund	52,565
Industrial incentives	51,344
Development of infrastructure projects	15,316
Other uses	85,845
Total for components units	<u>\$ 8,796,078</u>

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Notes to Basic Financial Statements

June 30, 2005

(12) Capital Assets

Capital assets activity for the year ended June 30, 2005 is as follows (expressed in thousands):

Primary Government

	Beginning balance (as restated)	Increases	Decreases	Ending balance
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 880,510	52,373	2,417	930,466
Construction in progress	1,107,690	486,858	322,932	1,271,616
Total capital assets, not being depreciated	1,988,200	539,231	325,349	2,202,082
Capital assets, being depreciated:				
Buildings and building improvements	6,118,776	381,498	8,099	6,492,175
Equipment	356,116	62,807	45,555	373,368
Infrastructure	417,336	—	—	417,336
Total capital assets, being depreciated	6,892,228	444,305	53,654	7,282,879
Less accumulated depreciation for:				
Buildings and building improvements	1,946,342	168,532	4,963	2,109,911
Equipment	191,413	33,780	44,539	180,654
Infrastructure	67,035	8,328	—	75,363
Total accumulated depreciation	2,204,790	210,640	49,502	2,365,928
Total capital assets, being depreciated, net	4,687,438	233,665	4,152	4,916,951
Governmental activities capital assets, net	6,675,638	772,896	329,501	7,119,033
Business-type activities:				
Total capital assets, being depreciated – equipment	4,986	81	53	5,014
Less accumulated depreciation of equipment	3,314	386	53	3,647
Total business-type activities capital assets, being depreciated, net	\$ 1,672	(305)	—	1,367

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Notes to Basic Financial Statements

June 30, 2005

Depreciation expense was charged to functions/programs of the primary government for the year ended June 30, 2005 as follows (expressed in thousands):

Governmental activities:	
General government	\$ 58,982
Public safety	22,498
Health	4,882
Public housing and welfare	80,347
Education	29,387
Economic development	14,544
Total depreciation expense – governmental activities	\$ 210,640
Total depreciation business-type activities – lotteries	\$ 386

The cost and accumulated depreciation of capital assets of the primary government as of beginning of year were increased by approximately \$705 million and \$67 million, respectively, to capitalize retroactively general infrastructure assets in accordance with transition standards of GASB Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments.

General infrastructure assets amounting to \$417 million represents the estimated cost of assets transferred to the Department of Natural and Environmental Resources (DNER) of the Commonwealth in 1997 upon completion of the Cerrillos Dam and Reservoir and the Portugues-River and Bucana-River Projects by the US Army Corps of Engineers. These infrastructure assets are reported within governmental activities and include dams, intake facilities and similar items built for flood control, water supply and recreational purposes. The Commonwealth also recorded a payable due to the US Army Corps of Engineers amounting to \$151 million for its estimated allocated share of the construction costs associated with these projects, together with accrued interest amounting to \$57 million computed based on an annual interest rate of 6.063%. The final debt agreement between DNER and U.S. Corps of Engineers has not been finalized and therefore terms and conditions could differ from those estimated. The accumulated depreciation was computed on the straight-line method over an estimated useful life of 50 years from the transfer date property to the current date. The related debt is expected to be payable on an annual basis over a 50 year period.

General infrastructure assets amounting to \$221 million were retroactively recorded as construction in progress pending completion of the related project.

In addition, the beginning balance of construction in progress of the primary government was reduced by approximately \$62 million to reclassify to accounts receivables accumulated cost of projects removed from the capital improvement program of the Public Building Authority, a blended component unit. The associated costs are being billed to the corresponding public agencies through debt service rentals and according to bond resolutions and lease agreements.

On August 17, 2001, the Legislature of the Commonwealth approved Act No. 120, which requires the conditional transfer of the ownership of certain real properties under the name of the Department of Recreation and Sports (DRS) of the Commonwealth to the municipalities of the Commonwealth. The land and the facilities were transferred at no cost to the municipalities. During fiscal year ended June 30, 2005,

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Notes to Basic Financial Statements

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land, building, and building improvements with a cost of \$804 thousands were transferred to several municipalities and recorded as an expense in the accompanying statement of activities for the year ended on June 30, 2005 to give effect to these transactions.

Discretely Presented Component Units

Capital assets activity of the discretely presented component units for the year ended June 30, 2005 is as follows (expressed in thousands):

	Beginning balance (as restated)	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Land	\$ 2,420,319	71,694	58,973	2,433,040
Art works	2,475	511	—	2,986
Transportation system	—	2,319,650	—	2,319,650
Construction in progress	10,577,958	2,241,458	3,218,948	9,600,468
Total capital assets, not being depreciated	13,000,752	4,633,313	3,277,921	14,356,144
Capital assets, being depreciated:				
Buildings and buildings improvements	7,933,458	656,105	49,727	8,539,836
Equipment	1,063,343	113,990	66,157	1,111,176
Infrastructure	19,932,926	290,246	4,620	20,218,552
Total capital assets, being depreciated	28,929,727	1,060,341	120,504	29,869,564
Less accumulated depreciation for:				
Buildings and buildings improvements	4,412,843	333,259	23,306	4,722,796
Equipment	660,780	83,775	34,635	709,920
Infrastructure	8,621,942	431,283	6,781	9,046,444
Total accumulated depreciation	13,695,565	848,317	64,722	14,479,160
Total capital assets, being depreciated, net	15,234,162	212,024	55,782	15,390,404
Capital assets, net	\$ 28,234,914	4,845,337	3,333,703	29,746,548

The Puerto Rico Highway and Transportation Authority restated its financial statements to capitalize interest cost on constructed assets. The net effect of the restatement was to increase 2004 capital assets and net assets by the amount of \$1.7 billion.

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Notes to Basic Financial Statements

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(13) Tax Revenue Anticipation Notes Payable

Tax revenue anticipation notes (TRANS) reported in the general fund were issued on September 24, 2004 at interest rates ranging from 2% to 3.5% and were paid on July 29, 2005. The TRANS amounted to \$800 million at June 30, 2005 plus accrued interest of approximately \$20 million. The proceeds of the TRANS were used to cover a temporary cash deficiency resulting from the timing differences between tax collections and the payments of current expenditures.

(14) Short- and Long-Term Obligations

Primary Government

(a) Summary of Short- and Long-Term Obligations

Short- and long-term obligations at June 30, 2005 and changes for the fiscal year then ended are as follows (expressed in thousands):

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June 30, 2005

	Balance at June 30, 2004	Debt issued	Capitalized or defeased	Debt paid or defeased	Net original issue premiums	Other net increases (decreases)	Balance at June 30, 2005	Due within one year
Governmental activities:								
Bonds payable:								
General obligation and revenue bonds	\$ 11,771,600	642,459	22,707	(227,495)	12,230	25,620	12,247,121	200,470
Qualified Zone Academy Bonds	47,936	—	—	—	—	—	47,936	—
Commonwealth appropriation bonds	2,758,066	—	5,896	(53,442)	—	4,719	2,715,239	78,365
Notes payable:								
Component units:								
GDB	1,756,816	3,891,873	—	(3,590,798)	—	—	2,057,891	197,372
Other	79,205	71,240	—	(13,897)	—	—	136,548	21,897
Total bonds and notes payable	16,413,623	4,605,572	28,603	(3,885,632)	12,230	30,339	17,204,735	498,104
Compensated absences								
Net pension obligation	1,386,873	—	—	(1,003,227)	—	1,067,674	1,451,320	838,933
Obligation under capital lease arrangements	4,177,387	—	—	—	—	302,408	4,479,795	—
	153,214	847	—	(7,385)	—	—	146,676	6,296
Other liabilities:								
Employees' Christmas bonus	102,820	—	—	(222,827)	—	287,540	167,533	167,533
Liability for federal cost disallowances	99,232	—	—	(2,039)	—	26,175	123,368	123,368
Liability for legal claims and judgments	219,183	—	—	(44,800)	—	766,900	941,283	164,801
Other	—	—	—	—	—	150,940	150,940	14,159
Total governmental activities	22,552,332	4,606,419	28,603	(5,165,910)	12,230	2,631,976	24,665,650	1,813,194
Business-type activities:								
Note payable to component units	1,028	197	—	(705)	—	—	520	—
Notes payable to third parties	148	—	—	(148)	—	—	—	—
Compensated absences	4,972	—	—	(4,981)	—	6,851	6,842	3,468
Obligation for unpaid lottery prizes	318,471	—	—	(32,649)	—	43,286	329,108	36,336
Claims liability for insurance benefits	71,108	—	—	—	—	(80)	71,028	71,028
Total business-type activities	395,727	197	—	(38,483)	—	50,057	407,498	110,832
Total governmental and business-type	\$ 22,948,059	4,606,616	28,603	(5,204,393)	12,230	2,682,033	25,073,148	1,924,026

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The balances of long-term debt issued included with other financing sources and debt service principal expenditure as reported in the statement of revenue, expenditures and changes in fund balances-governmental funds do not agree with amounts reported as debt issued and paid in the above table primarily because the above table includes debt issued and paid on short-term obligations which amounted to approximately \$3 billion and \$3.5 billion, respectively. The receipt and payment of short-term obligations is reported as a balance sheet transaction in the fund financial statements.

The other net increases in bonds and notes payable consist of deferred losses on refunding, net of amortization, and amortization of premiums on bonds. These adjustments did not require any source or use of cash.

Compensated absences, net pension obligation, obligation for unpaid lottery awards, liability for insurance benefits, and other long-term liabilities reflect other net increases (decreases) resulting from adjustments and changes to agree these obligations to their estimated balances at June 30, 2005.

(b) Debt Limitation

The Constitution of the Commonwealth authorizes the contracting of debts as determined by the Legislature. Nevertheless, the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amounts of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury (hereinafter internal revenue) in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenue consists principally of income taxes and excise taxes. Certain revenue, such as federal excise taxes on offshore shipments of alcoholic beverages, tobacco products, and customs duties, which are collected by the U.S. government and returned to the Commonwealth, and motor vehicle fuel taxes and license fees, which are allocated to the PRHTA, a discrete component unit, are not included as revenue for the purpose of calculating the debt limit, although they may be available for the payment of debt service. At June 30, 2005, the Commonwealth is in compliance with the debt limitation requirement.

(c) Bonds Payable

The Constitution of the Commonwealth provides that public debt will constitute a first claim on the available revenue of the Commonwealth. Public debt includes general obligations and notes of the Commonwealth and any payment required to be made by the Commonwealth under its guarantees of bonds issued by blended or discretely presented component units. The good faith, credit, and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal and interest of the general obligation bonds.

Act No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. The levy is

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made by CRIM, a municipal corporation, not a component unit of the Commonwealth. CRIM is required to remit the 1.03% of property tax collected to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. During the year ended June 30, 2005, the total revenue and receivable reported by the Commonwealth amounted to approximately \$122 million and \$17.1 million, respectively, which are included in the debt service fund.

For financial reporting purposes, the outstanding amount of bonds represents the total principal to be repaid, net of unamortized premiums, discount, and deferred refunding losses; for capital appreciation bonds, it represents total principal and accreted interest to be repaid.

Bonds payable outstanding at June 30, 2005 are as follows (expressed in thousands):

	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Term bonds payable through 2036; interest payable semiannually at rates varying from 3% to 8%.	\$ 2,794,695	1,588,655	4,383,350
Serial bonds payable through 2024; interest payable semiannually at rates varying from 3.75% to 7.5%.	4,143,970	1,128,740	5,272,710
Capital appreciation bonds payable through 2031; no interest rate, yield ranging from 4.42% to 7.8%. Net of accreted discount of \$190 million.	240,829	171,202	412,031
The Children's Trust Fund tobacco settlement asset-backed bonds payable through 2026; interest payable annually at rates varying from 4.625% to 6%.	—	1,240,404	1,240,404
Capital Fund Program Bonds, maturing in various dates payable through 2024; interest payable at rates varying from 2% to 5%.	—	663,060	663,060
Bond payment obligation payable through 2010; interest payable at rates varying from 1.5% to 5.5%.	<u>125,910</u>	<u>—</u>	<u>125,910</u>
Balance carried forward	\$ <u><u>7,305,404</u></u>	<u><u>4,792,061</u></u>	<u><u>12,097,465</u></u>

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	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Balance brought forward	\$ 7,305,404	4,792,061	12,097,465
Yield curve bonds payable from 2009 through 2011; no interest rate, yield of 8.914%.	15,000	—	15,000
Yield retail bonds payable from 2009 through 2011; interest payable at rates varying from 2.875% to 5%.	26,000	—	26,000
Tax-exempt components maturing through 2007 and 2008; interest payable at rates ranging from 5.5% to 5.6%.	—	72,160	72,160
Inverse rate bonds payable from 2009 through 2011, interest payable at a rate of 6%.	15,000	—	15,000
Insured bonds payable from 2014 through 2018, interest payable at a rate of 5%.	64,360	—	64,360
Total	7,425,764	4,864,221	12,289,985
Unamortized premium	238,976	28,025	267,001
Deferred charges arising from debt refunding	(147,299)	(162,797)	(310,096)
Savings bonds	231	—	231
Total bonds payable	<u>\$ 7,517,672</u>	<u>4,729,449</u>	<u>12,247,121</u>

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During the year ended June 30, 2005, the following changes occurred in the bonds payable (expressed in thousands):

	<u>Outstanding at June 30, 2004</u>	<u>Issued</u>	<u>Premiums/ discount (redemptions)</u>	<u>Outstanding at June 30, 2005</u>
Term bonds	\$ 4,136,295	247,055	—	4,383,350
Serial bonds	5,151,695	222,835	(101,820)	5,272,710
Capital appreciation bonds	491,564	—	(79,533)	412,031
The Children's Trust Fund tobacco settlement				
asset-backed bonds	1,145,515	108,209	(13,320)	1,240,404
Capital Fund Program Bonds	663,060	—	—	663,060
Appropriation refunding bonds	10,115	—	(10,115)	—
Bond payment obligations	125,910	—	—	125,910
Yield curve bonds	15,000	—	—	15,000
Yield retail bonds	26,000	—	—	26,000
Tax-exempt components	72,160	—	—	72,160
Inverse rate bonds	15,000	64,360	—	79,360
Subtotal	11,852,314	642,459	(204,788)	12,289,985
Unamortized premium	278,165	12,230	(23,394)	267,001
Deferred charges arising from debt refunding	(359,110)	—	49,014	(310,096)
Savings bonds	231	—	—	231
Total	<u>\$ 11,771,600</u>	<u>654,689</u>	<u>(179,168)</u>	<u>12,247,121</u>

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Maturities of general obligations and of revenue bonds payable, including accrued interest of capital appreciation bonds, are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 200,470	628,834	829,304
2007	253,558	642,601	896,159
2008	278,264	597,437	875,701
2009	316,676	555,145	871,821
2010	361,785	533,553	895,338
2011 – 2015	2,016,002	2,436,235	4,452,237
2016 – 2020	2,375,082	1,922,659	4,297,741
2021 – 2025	2,325,966	1,294,611	3,620,577
2026 – 2030	1,668,493	809,207	2,477,700
2031 – 2035	1,496,069	404,587	1,900,656
2036 – 2040	608,844	129,267	738,111
2041 – 2045	229,956	26,400	256,356
Total	<u>\$ 12,131,165</u>	<u>9,980,536</u>	<u>22,111,701</u>
Plus: accreted discount	159,051		
Plus: unamortized premium	267,001		
Less: deferred charges arising from debt refunding	<u>(310,096)</u>		
Total	<u>\$ 12,247,121</u>		

(d) *Commonwealth Appropriation Bonds*

Over the years, GDB, as fiscal agent and bank for the Commonwealth, had extended lines of credit, advances, and loans to several agencies and component units in order to finance their capital improvement projects and to cover their operational deficits at the time. Throughout the years, these loans were refunded through the issuance of Commonwealth appropriation bonds issued by the Puerto Rico Public Finance Corporation (PFC), a blended component unit of GDB. PFC is the financing arm of GDB, which serves only as a conduit for the issuance of the bonds.

During June 2004, PFC advanced refunded through the PFC 2004 Series A and B and PFC 2003 Series A through C Refunding Commonwealth Appropriation Bonds, a portion of certain of its outstanding Commonwealth Appropriation Bonds issued on prior years (except for the Health Facilities and Services Administration bonds described below, where no portion was refunded). The Commonwealth recognizes a mirror effect of this advance refunding by PFC in its own debt in proportion to the portion of the Commonwealth's notes included in the PFC refunding. As a result, the Commonwealth considered defeased and therefore removed from the balance sheet the portion refunded of \$775.7 million. The repayment source for these bonds (both the refunding and unrefunded portions) consists of Commonwealth appropriations submitted for approval of the Legislature annually during the budget preparation process of the Commonwealth. The Legislature is not legally bound to appropriate funds for such repayments.

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The outstanding balance of the Commonwealth appropriation bonds (both the refunding and unrefunded portion combined) is comprised of the following obligations (expressed in thousands):

Act No. 164 restructuring	\$	1,502,914
Health Facilities and Services Administration		482,321
Office for the Improvement of Public Schools		337,564
Puerto Rico Maritime Shipping Authority (PRMSA)		275,921
Property tax settlement		116,519
Total Commonwealth appropriation bonds	\$	<u>2,715,239</u>

On December 17, 2001, Act No. 164 authorized certain government agencies and discretely presented component units to refund approximately \$2.4 billion of their outstanding obligations with GDB, for which no repayment source existed, over a period not exceeding 30 years, and to be repaid with annual Commonwealth appropriations not to exceed \$225 million. This refunding was done with Commonwealth appropriation bonds through several series issued by PFC during the period between December 2001 and June 2002.

Approximately \$1.5 billion of the aforementioned outstanding obligations belonged to the primary government, predominantly the Department of Health of the Commonwealth (health reform financing and other costs for approximately \$1.1 billion) and the Department of the Treasury of the Commonwealth (the fiscal year 2001 deficit financing of \$268 million and the obligation assumed for defective tax liens in the amount of approximately \$132 million). The bonds' balance of the Act No. 164 restructurings bears interest at rates ranging from 1.25% to 5.80%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 21,425	84,838	106,263
2007	23,355	83,725	107,080
2008	35,076	81,944	117,020
2009	37,031	79,997	117,028
2010	34,707	80,860	115,567
2011 – 2015	212,270	362,130	574,400
2016 – 2020	<u>293,861</u>	<u>283,222</u>	<u>577,083</u>
Balance carried forward	\$ <u>657,725</u>	<u>1,056,716</u>	<u>1,714,441</u>

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	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Balance brought forward	\$ 657,725	1,056,716	1,714,441
Year ending June 30:			
2021 – 2025	398,042	160,898	558,940
2026 – 2030	369,333	64,171	433,504
2031 – 2035	97,443	1,805	99,248
Total	1,522,543	1,283,590	2,806,133
Plus unamortized premium	24,878		
Less deferred charges arising from debt refunding	(44,507)		
Total	\$ 1,502,914		

As of July 1, 1999, approximately \$595 million (including unpaid interest) of a promissory note of the Health Facilities and Services Administration (HFSA) due to GDB was transferred to the Department of Health of the Commonwealth and restructured through Commonwealth appropriation bonds. The bonds bear interest at rates ranging between 5.90% to 6.20%. Principal and interest on the bonds are payable solely from legislative appropriations to be made pursuant to Act No. 223 of August 9, 1998. The act provides that OMB shall include in the annual budget of the Commonwealth an amount equal to \$56.5 million for the fiscal year 1998 – 99, and for the next succeeding 15 fiscal years the amount necessary to pay the principal of and interest on the bonds, up to a maximum annual amount of \$57.7 million. As of June 30, 2005, approximately \$482 million were still outstanding.

Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 34,540	23,191	57,731
2007	37,080	20,652	57,732
2008	39,600	18,133	57,733
2009	42,125	15,607	57,732
2010	44,865	12,867	57,732
2011 – 2015	189,145	97,538	286,683
2016 – 2018	94,966	77,096	172,062
Total	\$ 482,321	265,084	747,405

Previous public schools infrastructure improvement loans provided additional funds for major repairs and improvements to the public schools in Puerto Rico. This activity is administered by the Office for the Improvement of the Public Schools of Puerto Rico (OIPS), included as part of the general fund of the primary government. These loans were refunded originally through the issuance of

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Commonwealth appropriation bonds pursuant to Act No. 85 of June 13, 1998. The new combined bonds bear interest at rates ranging from 5.0% to 5.85%. As of June 30, 2005, approximately \$337.6 million were outstanding. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 9,090	18,503	27,593
2007	9,470	18,121	27,591
2008	9,945	17,648	27,593
2009	10,465	17,125	27,590
2010	10,990	16,602	27,592
2011 – 2015	70,560	69,083	139,643
2016 – 2020	77,590	46,196	123,786
2021 – 2025	92,740	23,521	116,261
2026	54,395	1,062	55,457
Total	345,245	227,861	573,106
Plus unamortized premium	7,078		
Less deferred charges arising from debt refunding	(14,759)		
Total	\$ 337,564		

A promissory note payable owed by PRMSA to GDB was assumed by the Commonwealth in connection with the sale of the maritime operations of PRMSA. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at a variable rate ranging from 3.00% to 7.30%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ —	16,907	16,907
2007	—	16,907	16,907
2008	—	16,907	16,907
2009	—	16,907	16,907
2010	3,415	16,793	20,208
2011 – 2015	55,290	77,531	132,821
2016 – 2020	77,765	60,371	138,136
2021 – 2025	99,085	37,328	136,413
2025 – 2030	92,940	9,293	102,233
Total, balance carried forward	\$ 328,495	268,944	597,439

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<u>Year ending June 30,</u>	<u>Principal</u>
Balance brought forward	\$ 328,495
Plus unamortized discount	(686)
Less deferred charges arising from debt refunding	(51,888)
Total	<u>\$ 275,921</u>

During fiscal year 1996, the Commonwealth refinanced the liability for the settlement of the property taxes owed to the municipalities of Puerto Rico. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at rates ranging from 5.87% to 7.25%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 13,310	5,083	18,393
2007	14,285	4,103	18,388
2008	15,350	3,040	18,390
2009	16,505	1,885	18,390
2010	17,750	643	18,393
2011 – 2015	61,245	30,735	91,980
Total	138,445	<u>45,489</u>	<u>183,934</u>
Plus accreted discount	5,896		
Less deferred charges arising from debt refunding	(27,822)		
Total	<u>\$ 116,519</u>		

(e) *Qualified Zone Academy Bonds*

During November 2001, the Department of Education of the Commonwealth issued a certification whereby certain Commonwealth public schools were designated as a “qualified zone academy” pursuant to Section 1397E of the U.S. Internal Revenue Code of 1986, as amended. On May 18, 2004, PFC, a blended component unit of GDB, issued \$47.9 million of Qualified Zone Academic Bonds (QZAB) to finance expenditures of the Department of Education of the Commonwealth under the aforementioned program, including rehabilitation and repairs of school buildings and other facilities, the development and implementation of academic curricula, technology training for some schools, and the costs of issuance of the bonds. These May 2004, QZAB are payable upon its maturity on May 2020, since the U.S. government grants tax exemptions to bond holders in lieu of an interest rate. Beginning in August 2004, annual appropriations from the general fund of the amount of approximately \$2.2 million will be made over the next 16 years and deposited in an escrow account, which along with accumulated earned interest will be sufficient to repay these bonds upon its maturity on 2020.

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(f) *Notes Payable to Component Units*

The Commonwealth financed certain short- and long-term liabilities through GDB and other component units. The outstanding balance on the financing provided is comprised of the following (expressed in thousands):

GDB

Department of the Treasury	\$ 1,649,734
Department of Education	122,816
Department of Agriculture	53,414
Department of Transportation and Public Works	44,541
Puerto Rico Court Administration Office	40,437
Department of Health	32,051
Department of Justice	31,406
Office of the Superintendent of the Capitol	18,834
Department of Recreation and Sports	16,090
Correction Administration	13,244
Public Building Authority	12,303
Police Department	9,698
Department of Natural and Environmental Resources	8,923
State Office for the Historic Conservation	3,540
Office of Veterans' Affairs	860
Notes payable to GDB	<u>\$ 2,057,891</u>

Other component units

Health facilities agreement payable to the Medical Science Campus of the UPR	\$ 87,140
Note payable to PREPA	<u>49,408</u>
Total notes payable to other component units	<u>\$ 136,548</u>
<i>Business-type Activities:</i>	
Line-of-credit agreement with GDB for the Traditional Lottery of Puerto Rico	<u>\$ 520</u>

The Department of the Treasury of the Commonwealth has entered into various interim line-of-credit agreements with GDB, from which approximately \$3 billion were drawn and repaid within the same year. These drawings and repayments mainly related to advances in anticipation of the issuance of the 2005 TRANS and to cover temporarily cash deficiencies between tax collections and payments of current expenditures, which were later repaid upon the actual tax collection and replenishment of the aforementioned deficiency. Other interim (short-term) financing, further described below had

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drawings and repayments amounting to \$8.6 million and \$492.7 million, respectively during fiscal year 2005.

As of June 30, 2005, the Department of the Treasury of the Commonwealth has entered into various line-of-credit agreements with GDB amounting to a maximum of \$1.6 billion for different purposes as presented in the following tables. The purpose, interest rate, maturity date, and amount outstanding under each individual agreement at June 30, 2005 consist of the following (expressed in thousands):

Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
To provide additional resources to meet the appropriations in the annual budget of the Commonwealth (fiscal year 2005)	125 bp over three-month LIBOR	June 30, 2014	\$ 550,000	550,000
Replenishment of income tax refund reserve (fiscal year 2004)	125 bp over three-month LIBOR	June 30, 2008	250,000	238,924
Resources to meet appropriations in annual budget of Commonwealth and partial repayments of TRANS	125 bp over three-month LIBOR	July 31, 2009	233,000	233,000
To meet appropriations in annual budget of Commonwealth (fiscal year 2004) and federal program expenditures	125 bp over three-month LIBOR	June 30, 2005	640,000	156,744
To fund capital improvement projects of agencies and municipalities	150 bp over GDB's commercial paper rate	June 30, 2019	130,000	93,844
Acquisition of safety and security equipment for certain Commonwealth agencies	150 bp over GDB's commercial paper rate	September 30, 2007	105,000	88,806
To repay various agencies' old debts	125 bp over three-month LIBOR	September 30, 2012	100,000	78,130
To meet program expenditures of the Puerto Rico Health Insurance Administration and the Department of the Family	125 bp over three-month LIBOR	September 30, 2015	79,930	37,617

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(Continued)	Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
	To meet program expenditures of the Department of Transportation and Public Works	2.5%	September 30, 2008	44,300	32,715
	To cover deficit in certain elderly and childcare programs of the Department of the Family	125 bp over three-month LIBOR	September 30, 2011	30,000	30,000
	To repay agencies' outstanding debt to PBA	125 bp over three-month LIBOR	September 30, 2008	40,000	22,665
	To fund information technology project	150 bp over GDB's commercial paper rate	September 30, 2008	44,868	20,646
	To pay debt with Municipal Revenue Collection Center	125 bp over three-month LIBOR	September 30, 2011	16,241	16,241
	To pay outstanding debt of various agencies with the Puerto Rico Telephone Company	125 bp over three-month LIBOR	September 30, 2008	16,000	16,000
	To stimulate economy in municipalities of Ceiba and Naguabo	125 bp over three-month LIBOR	September 30, 2001	15,000	14,500
	To acquire correctional facilities	125 bp over three-month LIBOR	September 30, 2012	15,000	11,552
	Resources to cover the operational needs of the catastrophic disasters fund liability (fiscal year 2004)	125 bp over three-month LIBOR	July 31, 2006	8,000	6,842
	Purchase of mobile X-ray machines	125 bp over three-month LIBOR	June 30, 2008	12,000	1,508
				<u>\$ 2,329,339</u>	<u>1,649,734</u>

On February 6, 2003, the Department of Education of the Commonwealth entered into a \$25 million line-of-credit agreement with GDB for the purchase of equipment and for school improvements. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2008. As of June 30, 2005, \$7.8 million were outstanding. The line-of-credit agreement will be repaid from future legislative appropriations. On August 4, 2002, the Department of Education entered into an additional \$140 million line-of-credit agreement with GDB in order to reimburse the Department of the Treasury for payments made on their behalf for state funds used to fund federal program expenditures. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2007. As of June 30, 2005, \$115 million was outstanding related to the borrowing. The line-of-credit will be repaid with federal grants. On August 30, 2002 the Department of Education also entered into a \$2.3 million line-of-credit agreement with GDB for the construction of school facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on July 1, 2006. At June 30, 2005 no amounts had been drawn under this line-of-credit.

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On August 9, 1999, the Department of Agriculture of the Commonwealth entered into a \$125 million non-revolving line-of-credit agreement with GDB to provide economic assistance to the agricultural sector which sustained severe damages caused by Hurricane Georges in 1998. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2014. As of June 30, 2005, \$53.4 million remains outstanding. The line-of-credit will be repaid from future legislative appropriations.

On October 31 2003, the Department of Transportation and Public Works (DTPW) entered into a \$15 million line-of-credit agreement with GDB for the construction and repavement of roads. Borrowings under this line-of-credit agreement bear interest at variable rates and was payable upon maturity of the line-of-credit on June 30, 2005. As of June 30, 2005, \$15 million still remained outstanding and is expected to be repaid within the following fiscal year. On March 8, 2004, the DTPW entered into an additional \$26 million line-of-credit agreement with GDB for the improvement and maintenance of the roads around the island. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June, 30 2010. As of June 30, 2005, this line-of-credit has an outstanding balance of approximately \$17.5 million was outstanding. On November 16, 2004, the DTOW entered into another (\$33 million) line-of-credit agreement with GDB for similar purposes. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October, 31 2010. As of June 30, 2005, \$12 million remains outstanding related to these borrowings.

On May 7, 2001, the Puerto Rico Court Administration Office (the Office) entered into a \$49.4 million nonrevolving line-of-credit agreement with GDB for operating purposes. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month London Interbank Offered Rate (LIBOR) plus 1%, not to exceed 8%. The Office must deposit \$6 million a year, from the total fees collected on the filing of civil cases, in a special fund created by the Department of the Treasury of the Commonwealth, which is pledged for repayment until July 31, 2015. As of June 30, 2005, approximately \$40.4 million remains outstanding.

On August 2003, the Department of Health of the Commonwealth entered into a \$30 million line-of-credit agreement with GDB in order to repay certain outstanding debts that the Puerto Rico Medical Services Administration (PRMSA) had with other agencies and suppliers. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon maturity of the line-of-credit on June 30, 2012. As of June 30, 2005, \$30 million related to this line-of-credit agreement was outstanding. On November 8, 2004, the Department of Health entered into an additional \$58.5 million line-of-credit agreement with GDB for the financing of a project of the Department of Health and PRMSA. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October, 31 2014. As of June 30, 2005, this line-of-credit agreement amounted to \$2.1 million

On October 2, 2002, the Department of Justice of the Commonwealth entered into a \$90 million line-of-credit agreement with GDB for the financing of 12 public improvements projects for the Municipality of Ponce pursuant to a court order. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on September 30,

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2014. As of June 30, 2005, \$31.4 million related to this line of credit agreement was outstanding. The line-of-credit will be repaid from future Commonwealth appropriations.

On June 21, 2001, the Office of the Superintendent of the Capitol (Superintendent) entered into a \$10 million line-of-credit agreement with GDB for the construction of a parking lot. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from future Commonwealth appropriations commencing in fiscal year 2003 through fiscal year 2006. As of June 30, 2005, \$5.1 million related to the line-of-credit agreement were outstanding. On February 15, 2002, the Superintendent entered into an additional \$35 million line-of-credit agreement with GDB for the acquisition and remodeling of several buildings under their jurisdiction. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from future legislative appropriations commencing in fiscal year 2003 through fiscal year 2008. As of June 30, 2005, \$13 million remained outstanding from the line-of-credit agreement. Although the amount drawn through June 30, 2005 is expected to be repaid within one year, this line of credit is nevertheless classified as long-term since the maximum amount of \$10 million, when drawn completely will be repaid in various installments through fiscal year 2008.

On October 23, 2002, the Department of Recreation and Sports of the Commonwealth (DRS) entered into a \$17.5 million line-of-credit agreement with GDB for the development of a recreational complex and other facilities in San Juan, which will eventually become the DRS' principal office headquarters. Borrowings under this line-of-credit agreement bear interest at variable rates and was payable upon the maturity of the line-of-credit on September 30, 2008. As of June 30, 2005 \$13.5 million remains outstanding. The line-of-credit will be repaid from future Commonwealth appropriations. On January 29, 2004, DRS also entered into an additional \$16 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2005, therefore considered a short-term fund liability. As of June 30, 2005, \$2.5 million remains outstanding and is expected to be repaid within the following fiscal year. This line of credit will be repaid from future Commonwealth appropriations. On January 18 2005, the DRS also entered into a \$17.2 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June, 30 2010. As of June 30, 2005, \$175 thousand were outstanding.

On August 28, 2000, GDB approved an amendment to the terms of two line-of-credit agreements of the Correction Administration by which such debts would be repaid between fiscal years 2000 and 2006. The two agreements were issued by GDB in August 1998 to partially fund permanent improvements to correctional facilities. The agreements have variable interest rate and limits of \$60 million and \$15 million. Their outstanding balance as of June 30, 2005 is \$3.8 million. On May 12, 2004, the Correction Administration entered into an additional \$60 million line-of-credit agreement with GDB for improvements to certain correctional facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June, 30 2010. As of June 30, 2005, \$9.5 million were outstanding. The line-of-credit will be repaid from future Commonwealth appropriations.

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June 30, 2005

At June 30, 2005, the Public Building Authority (PBA) capital project fund had advances outstanding from GDB in the amounting to approximately \$12.3 million represented by an interim construction line-of-credit agreement to finance the construction activities of PBA. These advances bear interest at 1.50% over the cost of tax exempt commercial paper issued by GDB.

On June 10, 2004, the Police Department entered into a \$48 million line-of-credit agreement with GDB for the acquisition of vehicles and high technology equipment. Borrowings under this line-of-credit agreement bear interest at variable rate and are payable upon the maturity of the line of credit on September 30, 2014. The outstanding balance of this line-of-credit agreement amounted to \$9.7 million at June 30, 2005.

On August 21, 2002, the Department of Natural and Environmental Resources of the Commonwealth (DNER) entered into a \$22.7 million line-of-credit agreement with GDB for the canalization of the Bucaná River. Borrowings under this line of credit agreement bear interest at variable rates and was payable upon the maturity of the line-of-credit on June 30, 2005. As of June 30, 2005, \$ 8.3 million remains outstanding under the line-of credit agreement. The line-of-credit will be repaid from future Commonwealth appropriations. On September 3, 2003, the DNER also entered into a \$2 million line-of-credit agreement with GDB for the canalization of Guayanilla River. Borrowings under this line-of-credit agreement bear interest at variables rates and are payable upon the maturity of the line-of-credit on June, 30 2007. As of June 30, 2005, \$595 thousand were outstanding.

On August 1, 2001, the State Office for the Historic Conservation entered into a \$4.5 million line-of-credit agreement with GDB for the construction and conservation of the Santa Catalina Palace and the Real Audiencia building. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on December 31, 2008. As of June 30, 2005, the outstanding balance of this line-of-credit agreement amounts to \$ 3.5 million. The line-of-credit will be repaid from future Commonwealth appropriations.

On October 20, 2004, the Office of Veterans' Affairs entered into a \$1.6 million line-of-credit agreement with GDB to provide economic assistance and housing-leasing services to Puerto Rican veterans. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June, 30 2006. As of June 30, 2005, \$860 thousand was outstanding.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

As of July 1, 1999, debts of approximately \$102 million from various agreements payable to UPR, a discretely presented component unit, in relation to outstanding noninterest-bearing debt accumulated in prior years by HFSA were transferred to the Commonwealth. On September 7, 2004, additional debts of approximately \$71.2 million were also restructured and combined with the previous financing arrangement. During fiscal year 2005, an installment of \$7.6 million was paid by Commonwealth under this arrangement. As of June 30, 2005, \$87.1 million remains outstanding. Future amounts required to pay principal balances at June 30, 2005 are as follows (expressed in thousands):

Year ending June 30:

2006	\$	15,570
2007		15,570
2008		15,570
2009		7,570
2010		7,570
2011 – 2014		<u>25,290</u>
Total	\$	<u><u>87,140</u></u>

The noninterest-bearing note payable to PREPA, a discretely presented component unit, consists of \$25.3 million of fuel adjustment subsidy due by the Commonwealth and the refinancing during 2004 of \$24.1 million of other accumulated debt by Commonwealth's agencies with PREPA. Future amounts required to pay principal balances at June 30, 2005 are as follows (expressed in thousands):

Year ending June 30:

2006	\$	6,327
2007		6,327
2008		6,327
2009		6,327
2010		<u>24,100</u>
Total	\$	<u><u>49,408</u></u>

The Department of the Treasury of the Commonwealth entered into a line-of-credit agreement with GDB for the purpose of financing the costs of a new series of lottery tickets for the Lottery of Puerto Rico. The line-of-credit has a limit of \$2.5 million, maturing on July 1, 2007 and accruing interest at an annual rate of 6.5%. Annual interest payment commitments through 2007 are estimated in \$68,000. The outstanding balance of this line-of-credit agreement as of June 30, 2005, is \$520 thousand.

(g) *Compensated Absences*

Long-term debt includes approximately \$1,458 million accrued vacation and sick leave benefits at June 30, 2005. The total liability of compensated absences recorded as governmental and business-type activities amounted to \$1,451 million and \$7 million, respectively.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

(h) Net Pension Obligation

The amount reported as net pension obligation of approximately \$4.5 billion represents the cumulative amount owed by the Commonwealth for the unfunded prior years' actuarially required pension contributions to the ERS and the TRS (collectively known as the pension plans) (see note 19). The net pension obligation has been recorded as a liability in the governmental activity in the accompanying statement of net assets.

(i) Unpaid Lottery Prizes

The amount reported as unpaid lottery prizes represents the lottery prizes payable of the Lottery of Puerto Rico (commonly known as Traditional Lottery) and the additional lottery system (commonly known as Lotto) jointly known as the Lottery Systems at June 30, 2005. The minimum annual payments related to unpaid awards of both lotteries are as follows (expressed in thousands):

	Principal	Interest	Total
Year ending June 30:			
2006	\$ 36,336	—	36,336
2007	32,157	1,148	33,305
2008	30,971	2,302	33,273
2009	29,820	3,453	33,273
2010	28,673	4,600	33,273
2011 – 2015	110,851	32,768	143,619
2016 – 2020	49,165	30,438	79,603
2021 – 2025	11,135	11,226	22,361
Total	\$ 329,108	85,935	415,043

The liability for unpaid lottery prizes is reported in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

(j) Claims Liability for Insurance Benefits

The Commonwealth provides unemployment compensation, nonoccupational disability, and drivers' insurance coverage to public and private employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth. These insurance programs cover workers against unemployment, temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment.

The Commonwealth establishes liabilities for incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. Insurance benefit claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The liability for insurance benefits claims is reported as a current liability in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

(k) *Obligations Under Capital Lease Arrangements*

The Commonwealth is obligated under capital leases with third parties that expire through 2034 for land, buildings, and equipment. At June 30, 2005, the capitalized cost of the land, buildings, and equipment amounted to approximately \$185 million and is included as part of capital assets in the accompanying statement of net assets.

The present value of future minimum capital lease payments at June 30, 2005 reported in the accompanying statement of net assets is as follows (expressed in thousands):

Year ending June 30:		
2006	\$	17,764
2007		14,873
2008		14,445
2009		13,627
2010		13,398
2011 – 2015		66,428
2016 – 2020		61,681
2021 – 2025		56,934
2026 – 2030		56,099
2031 – 2034		14,633
Total future minimum lease payments		<u>329,882</u>
Less amount representing interest costs		<u>(183,206)</u>
Present value of minimum lease payments	\$	<u><u>146,676</u></u>

Land, buildings, and equipment held under capital leases at June 30, 2005 included within capital assets is comprised of the following (expressed in thousands):

Land	\$	7,960
Buildings		146,202
Equipment		<u>30,988</u>
Subtotal		185,150
Less accumulated amortization		<u>(42,691)</u>
Total	\$	<u><u>142,459</u></u>

Amortization charge applicable to capital leases and included within depreciation expense of capital assets amounted to approximately \$7 million in 2005.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

The Commonwealth is also committed under numerous operating leases, covering land, office facilities, and equipment. Rental expenditures within the governmental funds for the year ended June 30, 2005, under such operating leases were approximately \$149 million.

The future minimum lease payments for these leases are as follows (expressed in thousands):

Year ending June 30:		
2006	\$	93,261
2007		73,642
2008		58,042
2009		37,742
2010		20,977
2011 – 2015		63,340
2016 – 2020		4,848
2021 – 2025		<u>3,903</u>
Total future minimum lease payments	\$	<u><u>355,755</u></u>

(l) *Other Long-Term Liabilities*

The remaining long-term liabilities of governmental activities at June 30, 2005 include (expressed in thousands):

Employees' Christmas bonus	\$	167,533
Liability for federal cost disallowances		123,368
Liability for legal claims and judgments (note 18)		941,283
Liability to U.S. Army Corps of Engineers (note 12)		<u>150,940</u>
Total	\$	<u><u>1,383,124</u></u>

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

As described in note 12, the Commonwealth has a debt obligation with the U.S. Army Corps of Engineer in relation to the construction of the Cerrillos Dam and Reservoir Project and the Portugues-River and the Bucana-River Projects. Although a final agreement has not been reached, the expected debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 14,159	67,816	81,975
2007	815	8,296	9,111
2008	865	8,244	9,109
2009	917	8,191	9,108
2010	973	8,136	9,109
2011 – 2015	5,823	39,718	45,541
2016 – 2020	7,816	37,725	45,541
2021 – 2025	10,491	35,051	45,542
2026 – 2030	14,081	31,461	45,542
2031 – 2035	18,900	26,642	45,542
2036 – 2040	25,367	20,174	45,541
2041 – 2045	34,048	11,494	45,542
2046 – 2047	16,685	1,532	18,217
Total	<u>\$ 150,940</u>	<u>304,480</u>	<u>455,420</u>

(m) *Advance Refunding, Defeased Bonds, and Refunding of Special Promissory Notes*

In prior years, the Commonwealth defeased certain general obligation and other bonds by placing the proceeds of bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trusts' account assets and liabilities for the defeased bonds are not included in the basic financial statements. At June 30, 2005, approximately \$2.1 billion of bonds outstanding from prior years advance refunding are considered defeased.

In addition, PBA, a blended component unit has defeased certain revenue bonds in prior years by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old debts. Accordingly, the trust account's assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2005, approximately \$765 million of PBA bonds are considered defeased.

On December 12, 2001, PFC, a blended component unit of GDB, issued \$96.8 million of QZAB to finance expenditures of the Department of Education of the Commonwealth under the QZAB program described in note 14(e), including rehabilitation and repairs of school buildings and other facilities, the development and implementation of academic curricula, technology training for some schools, and the costs of issuance of the bonds. These QZAB are payable upon its maturity on December 11, 2015. Simultaneous with the QZAB issuance, The Children's Trust, a blended component unit of the Commonwealth, granted \$47.2 million to the Department of Education of the

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

Commonwealth, which in turn deposited the moneys to the credit of an escrow trust account invested in guaranteed investment contracts that will be used solely for the repayment in 2015 of these QZAB. These November 2001 QZAB are considered defeased and the difference between the bond amount and the amount deposited in the escrow account has been deferred and is amortized into income over the term of the bonds.

Fiduciary Funds

On August 1, 1996, the TRS entered into a loan agreement with AFICA, a discretely presented component unit, to secure AFICA's issuance of \$26.9 million of industrial revenue term bonds. The bonds were issued under a trust agreement and are secured by a pledge of certain marketable securities of the TRS.

The proceeds from the sale of the bonds were lent by AFICA to TRS to finance the acquisition of certain buildings and related facilities and to pay certain expenses incurred in connection with the issuance and sale of the bonds.

Bonds payable outstanding at June 30, 2005, are as follows (expressed in thousands):

Term Bonds Series A payable through 2012, interest payable on a monthly basis at rates varying from 6.50% to 6.65%	\$	6,075
Term Bonds Series B payable through 2022, interest payable semiannually at 5.50%		<u>15,210</u>
Total	\$	<u><u>21,285</u></u>

Maturities of the term bonds are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 855	1,239	2,094
2007	915	1,184	2,099
2008	975	1,123	2,098
2009	1,040	1,058	2,098
2010	1,110	989	2,099
2011 – 2015	6,290	3,859	10,149
2016 – 2020	8,180	1,926	10,106
2021 – 2022	<u>1,920</u>	<u>106</u>	<u>2,026</u>
Total	\$ <u><u>21,285</u></u>	<u><u>11,484</u></u>	<u><u>32,769</u></u>

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

The Series A and Series B Bonds are subject to redemption, at the option of the TRS, in whole or in part on July 1, 2006, or any date thereafter at the determined redemption prices plus accrued interest to the redemption date as follows:

July 1, 2006 through June 30, 2007	102%
July 1, 2007 through June 30, 2008	101
July 1, 2008 and thereafter	100%

The TRS has also entered into a \$15 million line-of-credit agreement with GDB, due on October 31, 2010, and guaranteed by a pool of investments of the TRS. At June 30, 2005, the outstanding balance of the line of credit was \$4,000 bearing interest at an annual interest rate of 5%.

Discretely Presented Component Units

Notes and bonds payable are those liabilities that are paid out of resources pledged by the other component units. These notes and bonds do not constitute a liability or debt of the Commonwealth.

The outstanding balance of notes payable outstanding at June 30, 2005 is as follows (expressed in thousands):

Component Unit	Interest rate	Maturity through	Balance at June 30, 2004	Increases	Decreases	Balance at June 30, 2005	Amounts due within one year
Government Development Bank for Puerto Rico	1.97%	2006	\$ 935,085	7,579,288	7,301,696	1,212,677	1,212,677
Puerto Rico Electric Power Authority	2.6 – 4.45	2012	5,000	41,585	5,000	41,585	4,750
State Insurance Fund Corporation	discounted notes 6.31 – 6.84	2019	56,638	—	1,386	55,252	1,659
Economic Development Bank for Puerto Rico	4.2 – 5.4	2025	355,234	367,000	322,234	400,000	—
Puerto Rico Industrial Development Company	5.0004 – 6.4785	2024	62,675	1,832	1,474	63,033	1,962
Puerto Rico Land Authority	488.00%	2010	—	14,845	4,241	10,604	2,121
Puerto Rico Ports Authority	3.25 – 4.50	2024	63,300	60,807	1,344	122,763	28,617
Total notes payable, component units			\$ 1,477,932	8,065,357	7,637,375	1,905,914	1,251,786

Notes payable of \$125 million of PREPA, not included in the table above, have no fixed maturity date and variable interest rates. For financial reporting purposes, these notes have been classified as due within one year. These had no increases or decreases during 2005.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

Debt service requirements on component units' notes payable with fixed maturities at June 30, 2005 were as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 1,376,786	28,058	1,404,844
2007	45,197	27,704	72,901
2008	9,764	27,242	37,006
2009	11,071	26,821	37,892
2010	12,495	26,462	38,957
2011 – 2015	67,479	125,257	192,736
2016 – 2020	91,108	108,866	199,974
2021 – 2025	417,014	57,161	474,175
Total	<u>\$ 2,030,914</u>	<u>427,571</u>	<u>2,458,485</u>

Commonwealth appropriation bonds payable outstanding at June 30, 2005 are as follows (expressed in thousands):

<u>Component Unit</u>	<u>Interest rate</u>	<u>Maturity through</u>	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>
Puerto Rico Aqueduct and Sewer Authority	5.50%	2031	\$ 715,382	1,477	7,583	709,276	3,198
Tourism Company of Puerto Rico	4.00 – 6.15	2031	127,570	565	1,217	126,918	572
Puerto Rico Land Authority	0.00	2031	158,993	2,439	—	161,432	718
Government Development Bank for Puerto Rico	4.00 – 6.15	2031	10,339	—	—	10,339	96
Puerto Rico Infrastructure Financing Authority	7.50	2031	10,651	—	—	10,651	99
Puerto Rico Solid Waste Authority	1.25 – 5.75	2029	6,707	995	—	7,702	—
Total notes payable, component units			<u>\$ 1,029,642</u>	<u>5,476</u>	<u>8,800</u>	<u>1,026,318</u>	<u>4,683</u>

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2005

Debt service requirements on component units' appropriation bonds payable with fixed maturities at June 30, 2005 were as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 4,683	57,831	62,514
2007	3,928	58,268	62,196
2008	15,107	57,553	72,660
2009	16,159	56,706	72,865
2010	15,362	55,858	71,220
2011 – 2015	100,015	251,888	351,903
2016 – 2020	152,448	202,569	355,017
2021 – 2025	188,709	148,621	337,330
2026 – 2030	437,178	75,850	513,028
2031 – 2035	113,924	2,233	116,157
Premium (discounts)	(21,195)	—	(21,195)
Total	<u>\$ 1,026,318</u>	<u>967,377</u>	<u>1,993,695</u>

Bonds payable outstanding at June 30, 2005 are as follows (expressed in thousands):

<u>Component Unit</u>	<u>Interest rate</u>	<u>Maturity through</u>	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>
Government Development							
Bank for Puerto Rico	5.00% – 6.25%	2035	\$ 1,601,961	—	143,912	1,458,049	86,660
Puerto Rico Infrastructure							
Financing Authority	1.10 – 7.90	2044	1,960,677	1,483,137	26,643	3,417,171	29,165
University of Puerto Rico	3.00 – 5.75	2030	499,526	2,271	18,525	483,272	19,560
Puerto Rico Municipal							
Finance Authority	3.00 – 8.62	2030	1,338,361	—	89,384	1,248,977	96,124
Puerto Rico Ports Authority	5.00 – 7.30	2021	74,048	182	3,970	70,260	4,250
Puerto Rico Aqueduct and							
Sewer Authority	3.5 – 8.22	2044	843,871	40,034	20,648	863,257	24,496
Puerto Rico Highway and							
Transportation Authority	2.00 – 6.50	2043	5,872,009	—	37,094	5,834,915	86,660
Puerto Rico Industrial							
Development Company	1.50 – 6.71	2029	306,087	7,609	15,155	298,541	10,271
Puerto Rico Electric Power							
Authority	3.00 – 7.00	2035	4,904,527	504,289	145,442	5,263,374	298,352
Total notes payable, component units			<u>\$ 17,401,067</u>	<u>2,037,522</u>	<u>500,773</u>	<u>18,937,816</u>	<u>655,538</u>

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Notes to Basic Financial Statements

June 30, 2005

Debt service requirements on component units' bonds payable with fixed maturities at June 30, 2005, were as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 655,538	610,167	1,265,705
2007	576,755	829,300	1,406,055
2008	515,516	853,660	1,369,176
2009	524,541	841,486	1,366,027
2010	516,768	929,276	1,446,044
2011 – 2015	3,176,761	3,840,983	7,017,744
2016 – 2020	3,567,830	2,831,428	6,399,258
2021 – 2025	3,069,480	1,992,281	5,061,761
2026 – 2030	3,385,898	1,395,749	4,781,647
2031 – 2035	1,918,641	926,639	2,845,280
2036 – 2040	1,357,791	398,845	1,756,636
2040 – 2044	388,964	307,428	696,392
Premium (discount), net	(716,667)	—	(716,667)
Total	<u>\$ 18,937,816</u>	<u>15,757,242</u>	<u>34,695,058</u>

Several component units have defeased certain revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old debts. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2005, the following bonds are considered defeased which pertain to major component units:

	<u>Amount outstanding at June 30, 2005 (in millions)</u>
Puerto Rico Highway and Transportation Authority	\$ 574
Puerto Rico Electric Power Authority	846

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Notes to Basic Financial Statements

June 30, 2005

(15) Guaranteed and Appropriation Debt

(a) *Guaranteed Debt*

The Commonwealth may provide guarantees for the repayment of certain borrowings of component units to carry out designated projects. At June 30, 2005, the following component unit debts are guaranteed by the Commonwealth (expressed in thousands):

	<u>Maximum guarantee</u>	<u>Outstanding balance</u>
Blended component unit:		
Public Buildings Authority	\$ 3,325,000	2,888,147
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	770,837	662,527
Government Development Bank for Puerto Rico	<u>342,000</u>	<u>267,000</u>
Total	<u>\$ 4,437,837</u>	<u>3,817,674</u>

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Notes to Basic Financial Statements

June 30, 2005

The Commonwealth has guaranteed the payments of rentals of its departments, agencies, and component units to PBA, a blended component unit, under various lease agreements executed pursuant to the law that created PBA. Such rental payments include the amounts required by PBA for the payment of principal and interest on the guaranteed debt as authorized by law. The rental commitment to cover principal and interest on the guaranteed debt (excluding premiums and deferred refunding losses) as of June 30, 2005 and for the next five years and thereafter follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2006	\$ 35,840	146,737	182,577
2007	56,855	152,464	209,319
2008	73,057	138,934	211,991
2009	80,684	134,992	215,676
2010	86,740	128,119	214,859
2011 – 2015	407,897	607,502	1,015,399
2016 – 2020	397,340	488,678	886,018
2021 – 2025	396,700	392,901	789,601
2026 – 2030	494,190	288,261	782,451
2031 – 2035	593,624	188,197	781,821
2036 – 2040	297,400	14,263	311,663
	<u>2,920,327</u>	<u>2,681,048</u>	<u>5,601,375</u>
Add (deduct) accreted discount	40,431	(40,431)	
Unauthorized premiums, discounts and deferred losses, net	<u>(72,611)</u>	<u>—</u>	
	<u>\$ 2,888,147</u>	<u>2,640,617</u>	

Rental income of PBA funds amounted to approximately \$279 million during the year ended June 30, 2005, of which \$139 million was used to cover debt service obligations.

Act No. 45 of July 28, 1994 states that the Commonwealth guarantees the payment of principal and interest of all outstanding bonds at the date the law was enacted and of all future bond issues to refinance those outstanding bonds of PRASA. During December 1995, PRASA issued refunding bonds to refinance all outstanding bonds amounting to approximately \$400.3 million. The outstanding balance of these refunding bonds at June 30, 2005, amounted to \$292 million. Act No. 140 of August 3, 2000, amended Act No. 45 to extend the Commonwealth guarantee to include the principal and interest payments of the Rural Development Serial Bonds and the loans under the State Revolving Fund Program (SRFP) outstanding at the effective date of Act No. 140, and of all future bonds and SRFP loans that may be issued until June 30, 2005. Act No. 386 of September 21, 2004, extended the Commonwealth guarantee to June 30, 2010. The outstanding balance of the Rural Development Serial Bonds and SRFP loans at June 30, 2005, amounted to \$215 million and \$155 million, respectively.

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Notes to Basic Financial Statements

June 30, 2005

The Commonwealth guarantees the Adjustable Refunding Bonds, Series 1985, issued by GDB, a discretely presented component unit. The outstanding balance of these bonds amounts to \$267 million at June 30, 2005.

The Puerto Rico Housing Bank, a former component unit of the Commonwealth, which merged with and into GDB during 2002, insured mortgages granted to low- and moderate-income families through its mortgage loan insurance program. The Commonwealth guarantees up to \$75 million of such mortgage loans. As of June 30, 2005, the mortgage loan insurance program was insuring loans aggregating \$424.6 million. Currently, the Commonwealth has not been called to make any direct payments pursuant to these guarantees.

(b) Appropriation Debt

At June 30, 2005, the outstanding balances of debt payable by Commonwealth appropriations, which are included in the individual financial statements of the following discretely presented component units, are as follows (expressed in thousands):

Puerto Rico Aqueduct and Sewer Authority	\$ 1,395,711
Special Communities Perpetual Trust	425,107
Puerto Rico Land Authority	161,432
Puerto Rico Convention Center District Authority	144,664
Tourism Company of Puerto Rico	126,919
Puerto Rico Solid Waste Authority	78,137
Agricultural Services and Development Administration	67,000
Puerto Rico Housing Finance Authority (a blended component unit of GDB)	64,259
Puerto Rico Infrastructure Financing Authority	12,585
Government Development Bank for Puerto Rico	10,339
Institute of Puerto Rican Culture	8,973
National Parks Company of Puerto Rico	6,831
Puerto Rico Electric Power Authority	2,431
University of Puerto Rico	2,243
Employment and Training Enterprises Corporation	662
Puerto Rico Industrial Development Company	381
Other governmental entities	206,171
Total	<u>\$ 2,713,845</u>

(16) Conduit Debt Obligations and No-Commitment Debt

To provide for the development and modernization of low-rent housing units, PHA has issued New Housing Authority bonds, permanent notes and federal financial bank (FFB) notes. These bonds and notes are payable by HUD and secured by annual contributions. The bonds and notes do not constitute a debt by PHA and accordingly have not been reported in the accompanying basic financial statements. As of June 30, 2005, outstanding HUD Permanent/FFB Notes and new Housing Authority Bonds approximate \$1 billion and \$71 million, respectively.

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From time to time, certain of the Commonwealth's component units issue revenue bonds to provide financial assistance to private-sector entities for the acquisition and construction of transportation, environmental, industrial, tourism, educational, commercial facilities, and Caribbean Basin projects deemed to be in the public interest and that are expected to provide benefits to Puerto Rico. These bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities is retained by the private-sector entity served by the bond issuance. Neither the Commonwealth nor any political subdivision or component unit thereof is obligated in any manner for the repayment of the bonds.

Accordingly, the bonds are not reported as liabilities in the basic financial statements of the issuing entities. As of June 30, 2005, conduit debt obligations consisted of the following bonds issued by component units (expressed in thousands):

<u>Issuing entity</u>	<u>Issued since inception to date</u>	<u>Amount outstanding</u>
Discretely presented component units:		
Puerto Rico Ports Authority	\$ 155,410	155,410
Puerto Rico Highway and Transportation Authority	\$ 270,000	153,856
Government Development Bank for Puerto Rico	\$ N/A	65,955
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	\$ 5,844,000	2,071,000

(a) Puerto Rico Ports Authority (PRPA)

PRPA issued Special Facilities Revenue Bonds under the provisions of two trust agreements between PRPA and a private bank. The proceeds from the sale of the bonds were used to finance the construction, acquisition of equipment, and improvement of certain facilities at Luis Muñoz Marín International Airport, for the benefit of a major private airline. The property is owned by PRPA and leased to the private company. Pursuant to the agreements between PRPA and the private company, the bonds will be paid from the rent collected from the airline in amounts sufficient to pay principal, premium (if any), and interest on the bonds. The airline has guaranteed these payments.

(b) Puerto Rico Highway and Transportation Authority (PRHTA)

In March 1992, PRHTA issued Special Facility Revenue Bonds for approximately \$117 million for the construction of a toll bridge. The proceeds from the sale of these bonds were transferred by PRHTA to a private entity, pursuant to a signed agreement for the construction, transfer, and operation of the bridge. The bonds shall be paid from the proceeds received by the private entity from the operation of the bridge. However, under certain circumstances, the private entity may have the right of terminating the agreement and PRHTA will assume the obligation to pay the bonds. The outstanding balance of these bonds at June 30, 2005 includes accreted interest.

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(c) GDB

The GDB, through its Housing Finance Authority, has issued notes and bonds in connection with the financing of low and moderate-income housing projects. Certain of the obligations issued are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements.

(d) AFICA

The revenue bonds of AFICA are used to finance facilities for environmental control, development of industrial and commercial companies, tourism projects, hospitals, and educational facilities. Pursuant to the loan agreements, the proceeds from the sales were borrowed by corporations and partnerships operating in Puerto Rico. The bonds are limited obligations of AFICA and, except to the extent payable from bond proceeds and investment thereof, will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreements between AFICA and each borrower. Furthermore, payment of the principal and interest on the revenue bonds is unconditionally guaranteed by each of the borrowers, their parent companies, or letters of credit from major U.S. banks or U.S. branches of international banks.

(17) Risk Management

The risk management program of the Commonwealth and most of its discretely component units are described in note 1(y). The following describes the risk management programs separately administered by certain discretely presented component units.

(a) UPR

The UPR is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The UPR carries commercial insurance for these risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Under Act No. 98 of August 24, 1994, the responsibility of UPR on medical malpractice claims is limited to a maximum amount of \$75,000 per person, or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risks liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claim liabilities does not necessarily result in an exact amount. Claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

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Changes in the claim liabilities amount for the two most recent fiscal years were as follows (expressed in thousands):

	<u>2005</u>	<u>2004</u>
Claims payable at beginning of year	\$ 13,598	13,158
Incurred claims and changes in estimates	27,299	3,311
Net payments for claims and adjustment expenses	<u>(20,637)</u>	<u>(2,871)</u>
Claims payable at end of year	<u>\$ 20,260</u>	<u>13,598</u>

Claims payable are reported as accounts payable and accrued liabilities in the accompanying statement of net assets.

(b) *PREPA*

PREPA is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. PREPA obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery, and public liability. The all-risk property and boiler and machinery policies have a combined coverage of \$650 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million and \$2 million for all other covered risks. The public general liability policy covers property damage and bodily injury to third parties with a \$75 million aggregate limit in excess of the self-retention limit of a \$1 million occurrence.

In addition, PREPA is self-insured for damage to its transmission and distribution lines. Transmission and distribution lines amounted to approximately \$3.2 billion at June 30, 2005. PREPA's self-insurance fund provides for its self-insurance risk. This fund represents principally net assets and restricted assets set-aside for self-insurance amounting to approximately \$63.4 million as of June 30, 2005.

PREPA has a cost plus health insurance program covering substantially all its employees. PREPA contracted an administrator for the processing, approval, and payment of claims at cost plus an administrative fee. The accrual includes claims processed and an estimate for claims incurred but not reported. Changes in the balances of the health insurance program and other self-insurance risks for the two most recent fiscal years were as follows (expressed in thousands):

	<u>2005</u>	<u>2004</u>
Claims payable at beginning of year	\$ 31,640	50,891
Incurred claims	127,207	92,822
Claim payments	<u>(126,244)</u>	<u>(112,073)</u>
Claims payable at end of year	<u>\$ 32,603</u>	<u>31,640</u>

Claims payable is reported as accounts payable and accrued liabilities in the accompanying statement of net assets.

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(c) **PRASA**

PRASA is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the property insurance program, PRASA has \$300 million blanket insurance on all real and personal property. The deductible for windstorm and flood is 2%, and 5% for earthquake with a maximum amount of \$7.5 million and \$3 million for flood. For property in transit, the deductible is \$150,000 per occurrence. This policy has a general limit of \$10 million per occurrence.

The comprehensive general liability and automobile liability have basic limits of \$2 million and the umbrella is \$20 million in excess of \$3 million, per occurrence. Also, there is an excess of loss coverage of \$45 million for losses in excess of \$28 million.

The boiler and machinery policy was included under the property insurance policy as an additional coverage; the directors and officers policy has a policy limits are \$20 million with a self-retention of \$500,000 per claim; the travel/accident policy has a \$2 million in aggregate coverage, and a limit of \$500,000 per person; the accidental and health policy for drivers has \$250,000 per person and \$1.8 million aggregate limit.

(d) **SIFC**

SIFC provides workers' compensation insurance to public and private employees. This insurance covers workers against injuries, disability, or death because of work or employment-related accidents, or because illness is suffered as a consequence of their employment. SIFC establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. The following table provides a reconciliation of the beginning and ending liability for incurred but unpaid benefits and benefit adjustment expenses for the year the two most recent fiscal years (expressed in thousands):

	<u>2005</u>	<u>2004</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 772,827	865,351
Total incurred benefits	403,866	285,314
Total benefit payments	<u>(442,931)</u>	<u>(377,838)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	<u>\$ 733,762</u>	<u>772,827</u>

The liability for incurred but unpaid benefits and benefit adjustment expenses is reported as accounts payable and accrued liabilities in the accompanying statement of net assets.

The liability for compensation benefits is based on historical claims experience data, assumptions and projections as to future events, including claims frequency, severity, persistency, and inflationary trends determined by an independent actuary. The actuarial study also included estimates for medical benefits, benefit adjustment expenses, and reimbursement of premiums. The assumptions

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used in estimating and establishing the liabilities are reviewed annually based on current circumstances and any adjustments resulting thereof are reflected in operations in the current period.

(e) AACA

AACA operates a system of compulsory insurance for vehicles licensed to be used on public roads and highways in Puerto Rico. This insurance covers death and bodily injuries caused by automobile accidents. The annual premium is \$35 per motor vehicle.

The following table provides a reconciliation of the beginning and ending liability for future benefits for the two most recent fiscal years (expressed in thousands):

	<u>2005</u>	<u>2004</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 109,845	113,562
Total incurred benefits	58,524	60,358
Total benefit payments	<u>(60,552)</u>	<u>(64,075)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	<u>\$ 107,817</u>	<u>109,845</u>

The liability for future benefits is reported as account payable and accrued liabilities in the accompanying statement of net assets. AACA has recorded this liability, including administrative expenses for claim processing, based on the results of actuarial reports prepared by independent actuaries, determined under two different methods. Death, funeral, disability, dismemberment, and the basic medical hospitalization liabilities were determined using a triangulation method. The extended benefits medical hospitalization reserve uses a regression methodology to predict the ultimate incurred claims for each incurred calendar quarter. Additionally, assumptions are made about the mortality rates of the extended benefit claimants, recognizing the impact of their traumatic injuries on life span.

Changes in the ultimate liabilities for benefit payments may be required as information develops which varies from experience, provides additional data, or, in some cases, augments data, which previously were not considered sufficient for use in determining the claim liabilities.

(18) Commitments and Contingencies

Primary Government

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Commonwealth only for causes of actions set forth in said act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Commonwealth may provide its officers

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and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, excluding the litigation mentioned in the following paragraphs, the Commonwealth reported approximately \$214 million as an amount to cover for awarded and anticipated unfavorable judgments at June 30, 2005. This amount was included as other long-term liabilities in the accompanying statement of net assets, and represents the amount estimated as probable liability or a liability with a fixed or expected due date that will require future available financial resources for its payment. The amounts claimed exceed \$11.7 billion; however, the ultimate liability cannot be presently determined. It is the opinion of management that the claims are excessive and exaggerated. Management believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

The Commonwealth is also a defendant in a lawsuit filed in a local district court by an association of primary care health centers seeking to recover from the Commonwealth \$127 million of Medicaid funds retained by the Department of Health of the Commonwealth since 1997. In June 2004, the First Circuit Court of San Juan determined that the Commonwealth must return these funds. The Commonwealth appealed this decision. As of June 30, 2005, the Commonwealth accrued \$127 million for this legal contingency.

The Commonwealth is a defendant in a class action presented by parents of special education students in the areas of education and health care. In October 2005 the San Juan Court of Appeals decided in favor of the parents' request to include damage claims pursuant to the same class action case although not as a remedy in the class action per se. The court now may award damages to the members of the class action and to do so it may look at the claims by dividing them into groups or consider each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each individual case. As of June 30, 2005, the Commonwealth accrued \$600 million for this legal contingency.

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On April 13, 2004, in anticipation of the issuance of the Commonwealth of Puerto Rico Public Improvement Refunding Bonds, Series 2004 B Bonds, GDB entered into interest rate exchange agreements (the Interest Rate Agreements) with two counterparties. At the same time, GDB entered into several mirror swap agreements (mirror swaps) with the Commonwealth in the notional amount of \$448 million. The purpose of the Interest Rate Agreements was to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith in relation to the Series 2004 B Bonds. The mirror swaps transfer the exposures and risks to the Commonwealth. On November 18, 2004, upon enactment of legislation that expressly authorizes the Commonwealth to enter into agreements of the nature of the Interest Rate Agreements and, among other things, to pledge the full faith, credit, and taxing power of the Commonwealth to all payment to be made under the agreements, the Interest Rate Agreements were transferred to the Commonwealth in exchange for the cancellation of the mirror swaps. At June 30, 2005, the Interest Rate Agreements consist of the following (in thousands):

Notional Amount	Floating rate indicator (LIBOR)	Receives		Pays		Maturity Date	Fair value
		Type	Rate at June 30, 2005	Type	Rate		
\$ 55,925	LIBOR	fixed	3.308%	variable	2.1396%	May 27, 2021	\$ (5,207)
56,000	LIBOR	fixed	3.582	variable	2.1396	June 27, 2024	(5,584)
56,000	LIBOR	fixed	3.559	variable	2.1722	June 29, 2027	(5,897)
55,975	LIBOR	fixed	3.575	variable	2.1522	June 29, 2028	(2,040)
19,290	LIBOR	fixed	3.570	variable	2.1755	June 29, 2029	(2,861)
30,710	LIBOR	fixed	3.570	variable	2.1788	June 29, 2029	(3,247)
50,000	LIBOR	fixed	3.573	variable	2.1630	June 29, 2029	(5,385)
61,975	LIBOR	fixed	3.574	variable	2.1722	June 29, 2031	(6,744)
62,000	LIBOR	fixed	3.509	variable	2.0227	June 29, 2032	(6,780)
<u>\$ 447,875</u>							<u>\$ (43,745)</u>

The Commonwealth receives financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal law and regulations, including the expenditure of resources for eligible purposes. Substantially all grants are subject to audit under Circular A-133 of the Office of Management and Budget of the United States of America (OMB Circular A-133), all of which are performed at the individual agency level. Disallowance as a result of these audits may become liabilities of the Commonwealth. At June 30, 2005, based on an evaluation of pending federal disallowances, the Commonwealth has recorded approximately \$123 million as other long-term liabilities in the accompanying statement of net assets.

Construction commitments at June 30, 2005, entered by PBA amounted to approximately \$274 million. In addition, the Commonwealth's construction commitments for public housing facilities amounted to approximately \$455 million at June 30, 2005.

On November 23, 1998, a global settlement agreement (the Agreement) was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The Agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies are to continue making contributions in perpetuity. Pursuant to Act No. 173 of July 30, 1999, which created The

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Children's Trust (a blended component unit), the Commonwealth assigned and transferred to The Children's Trust all payments that the Commonwealth is entitled to receive under the Agreement. Payments received under the Agreement and recognized as revenue during the year ended June 30, 2005, amounted to approximately \$71.4 million.

Following is a summary of estimated payments to be received by The Children's Trust through the year ending June 30, 2025 (expressed in thousands):

Year ending June 30:	
2006	\$ 75,990
2007	92,634
2008	94,017
2009	95,624
2010 – 2025	<u>1,550,232</u>
Total	<u>\$ 1,908,497</u>

At June 30, 2005, The Children's Trust, a blended component unit of the Commonwealth, had approved commitments to provide assistance to several entities through 90 contracts with balances amounting to approximately \$129.2 million.

Discretely Presented Component Units

In the normal course of their operations the various component units are subject to guarantees, actions brought by third parties seeking damages or entering into commitments. Such actions are disclosed in the separately issued reports of the component units some of which are summarized below:

(a) GDB

At June 30, 2005, GDB has financial guarantees for public entities for approximately \$75 million and for private sector of approximately \$79 million. In addition, standby letters of credit to public entities were approximately \$80 million and to private sector were approximately \$166 million. Commitments to extend credit to public entities were approximately \$2.9 billion and to private sector were approximately \$22 million.

GDB enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2005, there were agreements outstanding for \$439 million and during the year the average amount outstanding was approximately \$151 million, the maximum amount outstanding at any month-end was approximately \$439 million; and the weighted average interest rate for the year and at year-end was approximately 2.80% and 3.08%, respectively.

GDB issues commercial paper in the U.S. taxable and tax-exempt commercial paper markets, the Eurodollar commercial paper market, and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal

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Revenue Code Section 936. Commercial paper represents unsecured obligations of GDB. The carrying amount of commercial paper at June 30, 2005 was approximately \$1.2 billion; the maximum amount at any month-end was approximately \$1.2 billion; the weighted average amount outstanding during the year was approximately \$974 million and the weighted average interest rate for the year and at year-end was approximately 1.97% and 2.98%, respectively.

At June 30, 2005, GDB had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of \$437 million, having a fair value (payable position) of approximately \$15 million. GDB also had an equity appreciation index embedded in a \$200 million certificate of indebtedness. Such embedded derivative has been recognized as a liability at its fair value of approximately \$7 million as of June 30, 2005. GDB is exposed to credit loss in the event of nonperformance by the other parties to swap agreements. However, GDB does not anticipate nonperformance by counterparties.

On November 21, 2002, the Legislature of the Commonwealth approved Joint Resolution No. 1027, authorizing GDB to transfer \$500 million as a contribution to SCPT, a discretely presented component unit created for the purpose of financing a variety of initiatives, primarily housing and infrastructure, directed to the betterment of disadvantaged communities across the island. As approved in the Joint Resolution, the contribution will be disbursed following approved laws and regulations. The board of director of GDB approved a regulation (the Regulation), which calls for the disbursement of contributions based on the compliance with certain reimbursement requirements.

In addition, the Legislature approved on November 21, 2002 Joint Resolution No. 1028, which authorized the Special Communities Trust to borrow up to \$500 million in order to carry out the initiatives with which it was entrusted. The Joint Resolution authorizes GDB to provide such financing and requires the Director of the OMB to include in the budget of the Commonwealth submitted annually to the Legislature, for a period of ten fiscal years starting with the budget of fiscal year 2004 – 2005, the sum of \$50 million plus accrued interest for the repayment of such borrowing. The appropriations shall be made from the product of the sale of public improvement bonds issued during each of said fiscal years. GDB approved a line of credit with aggregate borrowings of \$500 million. Disbursements under this line of credit will also be subject to the Regulation.

On December 21, 2004, the Governor of the Commonwealth issued an executive order establishing the creation, through GDB, of an irrevocable trust to guarantee compliance with the above-mentioned Joint Resolutions. As established by the order, GDB will fund into the trust the previously unfunded amounts authorized under the Joint Resolutions. The beneficiary of the trust will be SCPT. Consequently, both the contribution and the loan were fully disbursed in December 2004. As of June 30, 2005, the loan balance was approximately \$425.1 million.

On August 6, 2003, GDB initiated foreclosure on the mortgage note it holds as collateral for the guarantee on the AFICA Cayo Largo bonds. The indenture of the bonds requires the repayment of the bonds before the execution of the mortgage note. Therefore, in order to execute the mortgage note, GDB called the outstanding balance of the bonds. Said bonds amounted to \$75.6 million. Resulting from the above-mentioned foreclosure proceedings, several of the principals of the Cayo Largo Hotel development (Cayo Largo Resort Associates, Cayo Largo Hotel, and D. Group Equity

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Holdings) have counterclaimed by filing complaints for alleged damages and breach of contract by GDB aggregating to approximately \$210 million. In addition, United States Fidelity and Guaranty Company (the Insurer) has filed an action to obtain a declaration that it is not bound to perform under the performance and payment bond executed in connection with the constructions and development of the project. Management believes that the ultimate outcome of all the counterclaims and other actions will not be material.

(b) PRHTA

PRHTA has entered into a System and Test Track Turnkey Contract (STTT Contract) with Siemens Transportation Partnership Puerto Rico, S.E., Juan R. Requena y Asociados, and Alternate Concepts, Inc. for the purpose of operating and maintaining the urban train system known as "Tren Urbano" once it begins operations. The STTT Contract will become effective upon the execution of the contract for an initial term of five years with an option by PRHTA to extend the term for an additional five years. The compensation is based on a schedule included in the master agreement which approximates \$4 million on a monthly basis. The total estimated annual operation and maintenance cost including cost of insurance and electricity for the first year of operations is approximately \$96.1 million.

During 2001, a number of contractors presented claims related to the PRHTA's Urban Train project. These contractors' claims, which are at various stages of analysis to reach a final resolution, amount to \$289 million. From this amount, \$166 million have been categorized as merited claims and recorded as accounts payable.

(c) PREPA

In May 1998, the Municipality of Ponce filed a complaint against PREPA in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes (CLT) and electric energy sales set aside in prior fiscal years. The complaint challenges the application of the "Net Revenues" used by PREPA in making deposits to certain funds required under the 1974 Bond Indenture Agreement and under a prior trust indenture (now terminated) for the purposes of paying costs of capital improvements. The Municipality of Ponce seeks a payment from PREPA in the amount by which the amount available to pay contributions in lieu of taxes and electric sales set aside to the Municipality of Ponce has been reduced as a result of such application. PREPA understands that the enabling act which created PREPA (the Act) provides that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with PREPA's deposit obligations under the 1974 Agreement and the prior indenture and that shortfalls do not carryforward as future liabilities of PREPA as described above.

On April 14, 2003, PREPA made a settlement offer consisting of a payment in cash of \$68 million and \$57 million for electric infrastructure projects in the municipalities. As part of the settlement agreement, the municipalities supported an amendment to the Act that was proposed by PREPA, that the amount payable to municipalities be calculated based on a percentage of the net revenues defined on the Act and the 1974 Bond Indenture Agreement. Prior to fiscal year 2005, 76 of the 78 municipalities of Puerto Rico had accepted the settlement receiving an aggregate amount of

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\$63.6 million. During fiscal year 2005, the remaining two municipalities accepted the settlement offer, receiving \$4.4 million.

The settlement required PREPA to submit legislation to change the CLT calculation. The new law signed in August 2004 included a transition clause regarding the \$68 million payment, stating that this amount was a special CLT that the accepting municipalities would receive with financing provided by GDB. The debt to GDB is guaranteed with the CLT.

In October 1994, PREPA signed a contract with AES Puerto Rico, L.P. (AES) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for 25 years. This project commenced operations in November 2002. In March 1995, PREPA also signed a contract with EcoEléctrica, L.P. (EcoEléctrica) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plant. The term of the agreement is for 22 years. This project has been in operation since 2000.

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico issued a report stating that PREPA overcharged its clients by approximately \$49.8 million and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by customers of PREPA demanding the reimbursement of such alleged overcharges. PREPA denies that any overcharges have been made.

(a) PRIFA

The law that created PRIFA (as amended) requires that the first \$70 million up to fiscal year 2006, and the first \$90 million in each fiscal year thereafter through 2052, of federal excise taxes received by the Commonwealth be transferred to PRIFA for deposit to PRIFA's infrastructure fund (the Infrastructure Fund). Federal excise taxes consist of taxes received by the Commonwealth from the United States in connection with rum and other articles produced in Puerto Rico and sold in the United States that are subject to federal excise tax.

A related trust agreement requires PRIFA to deposit to the credit of a sinking fund the federal excise taxes and other moneys deposited to the credit of the Infrastructure Fund in such amounts as are required to meet debt service requirements with respect to the bonds. Rum is the only article currently produced in Puerto Rico subject to federal excise tax, the proceeds of which are required to be transferred from the federal government to the Commonwealth.

The federal excise taxes securing the bonds are subject to a number of factors, including the continued imposition and remittance of such taxes to the Commonwealth and conditions affecting the Puerto Rico rum industry. If the federal excise taxes received by the Commonwealth in any fiscal year are insufficient to deposit the amount required by the law into the Infrastructure Fund, the law that enacted PRIFA requires that PRIFA request and the director of the OMB include in the annual budget of the Commonwealth for the corresponding fiscal year an appropriation necessary to cover such deficiency. The Commonwealth's Legislature, however, is not legally obligated to make the necessary appropriation to cover such deficiency.

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(b) PRTA

PRTA, through its subsidiary PRTA Holdings, holds shares of Telecomunicaciones de Puerto Rico, Inc. (TELPRI). TELPRI is the Puerto Rico corporation that was organized for the purpose of acquiring the stock of Puerto Rico Telephone Company (PRTC) and Celulares Telefónica (CT) from PRTA in connection with the sale transaction of March 2, 1999, where a subsidiary of Verizon, Popular, Inc., and TELPRI's employee stock ownership plan acquired 57% of TELPRI and completed the privatization of PRTC and CT. It is contemplated that all shares of TELPRI held by PRTA Holdings will be sold in public offerings and private placements, and all dividends and proceeds received from the sale of the shares will be distributed to the ERS. The PRTA's 43% investment in TELPRI was carried on the equity method of accounting through December 28, 2000. Although the ownership of the common stock of PRTA Holdings entitles PRTA to the voting right over TELPRI shares, no carrying value is recorded for its investment after the transfer of PRTA Holdings preferred stock to the Retirement System on December 28, 2000, since such preferred stock entitles the Retirement System to all the economic benefits of the investments in TELPR.

Verizon delivered a notice of claim for indemnity to PRTA related to certain alleged actions of PRTA that occurred before the closing of the sale transaction described above. The amount of indemnity sought by Verizon is approximately \$105 million, related to several matters including PRTC's exposure to a potential reduction in tariffs or required rebate to clients as a result of an adverse decision by the Federal Communications Commission (FCC) on a regulatory matter. The FCC's decision has been appealed by PRTC and the FCC denied such request. In June 2000, PRTA requested Verizon to provide additional information that would enable it to evaluate the merit of claims made, however, the additional information has not been submitted. Additionally, in connection with the privatization, the PRTA agreed to indemnify, defend, and hold TELPRI harmless for specified litigation in excess of \$50 million in the aggregate. Management believes that the final resolution of the legal cases will not have a material adverse affect of the financial position and results of operations of PRTA.

(c) PCSDIPRC

PCSDIPRC provides insurance coverage over the stocks and deposits of all the cooperatives and the Federation of Cooperatives of Puerto Rico. The deposit base of the cooperatives approximates \$5.9 billion at June 30, 2005.

(d) LAPR

At year-end, LAPR had approximately \$42.6 million in accruals to cover the estimated costs related to the liquidation of the Sugar Corporation of Puerto Rico, a blended component unit of LAPR, including, among others: employee severance, pending legal cases, environmental clean up costs, refinery repair costs, and estimated future losses to be incurred. Management believes these accruals to be sufficient; however, given the many uncertainties involved, the ultimate outcome cannot be determined with certainty at this time and the actual liquidation costs could be higher or lower than the estimates made.

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Fiduciary Component Unit

ERS enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2005, there were agreements outstanding for \$138 million and the weighted average interest rate at year-end was 3.44%.

Environmental Commitments and Contingencies

The following component units' operations include activities that are subject to state and federal environmental regulations:

- **PREPA** – Facilities and operations of PREPA are subject to regulations under numerous federal and Commonwealth environmental laws, including the Clean Air Act, Clean Water Act, and the National Pollutant Discharge Elimination System (NPDES). In February 1992, the U.S. Environmental Protection Agency (EPA) performed an inspection of various facilities of PREPA and became aware of deficiencies in different areas, principally air capacity; water quality; spill prevention control and countermeasures; and underground storage tanks. As a result, PREPA agreed to, among other things, make certain capital improvements, undertake supplemental environment project (SEPs) and use fuel oil not exceeding certain predetermined levels of sulfur, vanadium, and asphalt in its content.
- **PRASA** – Facilities and operations of PRASA's water and sewer system are subject to regulation under numerous federal and Commonwealth environmental laws. Under agreements with the federal government, acting on behalf of EPA, PRASA, and the Commonwealth, are subject to consent decrees to enforce compliance with environmental laws. During the year ended June 30, 2005, noncompliance penalties amounted to \$2.8 million. In addition, PRASA has committed to perform environmental projects, in lieu of penalties, in the amount of \$2 million as of June 30, 2005.
- **PRSWA** – PRSWA is currently involved in the implementation and development of the Infrastructure Regional Plan for Recycling and Disposal of Solid Waste in Puerto Rico. As of June 30, 2005, PRSWA has no insurance coverage for environmental risks and management believes that, at this time, there is no sufficient information available to determine the potential amount of related losses, if any, and no provision for losses has been made in the PRSWA's financial statements. Nevertheless, preventive infrastructure has been constructed an operational plans have been developed to minimize any possible impact or events that could occur.
- **PRLA** – PRLA was named a potential responsible party (PRPs) along with the Municipality of Juncos and other third parties for investigation and clean up costs under federal remediation laws for the contamination of the Juncos Landfill superfund site. On August 21, 2001, the U.S. Department of Justice (DOJ) proposed that the PRPs pay a total of \$5.5 million in settlement of EPA past cost claims, through November 2000, and the penalty and punitive damages claims relating to prior alleged noncompliance. A separate final agreement has been reached between PRLA and the Commonwealth's Housing Development and Improvement Administration where PRLA agreed to disburse \$227,500 and the Commonwealth's Housing Development and Improvement agreed to disburse \$422,500 which represents the total agreed amount of the public sector PRP's. EPA and DOJ signed settlement

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documents in August 2004. The execution of this settlement is pending to be performed. The separate agreement between the public sector PRP does not alter or modify the obligations assumed by both agencies with the U.S. government. Therefore, in the unlikely event of default by the Commonwealth's Housing Development and Improvement Administration, PRLA would be liable for payments of \$650,000. Management, after consulting with its legal counsel is of the opinion that this will not occur.

- **PRIDCO** – Financial responsibility for clean up costs has been and/or is being undertaken by the industrial potential responsible parties (PRPs) at the two Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA) sites (Vega Alta and Guayama), where the federal government named PRIDCO as a PRP solely for being a part owner of both sites. PRIDCO's participation in the site remediation efforts to date has been limited to providing in-kind support to the industrial PRP's implementation of the clean up programs and, consequently, has not involved any cash disbursements to the federal government or the industrial PRP groups. Under CERCLA and its regulations, liability for the clean up costs and damage to natural resources and any assessment of health effects may be imposed on the present and past owners or operators of a facility from which there was a release of hazardous substances. In addition, any person who arranged for the disposal or treatment of hazardous substances at a site from which there was a release may also be liable.

Construction Commitments

As of June 30, 2005, the following component units maintained various unspent construction agreements as follows (expressed in thousands):

Puerto Rico Highway and Transportation Authority	\$	917,753
Special Communities Perpetual Trust		574,497
Puerto Rico Aqueduct and Sewer Authority		452,000
Puerto Rico Ports Authority		234,550
Puerto Rico Electric Power Authority		413,600
University of Puerto Rico		144,409
Puerto Rico Infrastructure Financing Authority		128,300
Puerto Rico Solid Waste Authority		110,722
Puerto Rico Convention Center District Authority		46,256
State Insurance Fund Corporation		25,000
Puerto Rico Public Broadcasting Corporation		5,527
Puerto Rico Conservatory of Music Corporation		4,260
Cardiovascular Center Corporation of Puerto Rico and the Caribbean		1,603
Fine Arts Center Corporation		1,453
Institutional Trust of the National Guard of Puerto Rico		962
Puerto Rico Maritime Transportation Authority		773
Total	\$	<u>3,061,665</u>

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(19) Retirement Systems

The Commonwealth sponsors three contributory pension plans (collectively known as the Retirement Systems), which are reported in the accompanying statement of fiduciary net assets:

- Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities
- The Puerto Rico Judiciary Retirement System
- Puerto Rico System of Annuities and Pensions for Teachers

Each system is independent; thus their assets or liabilities may not be transferred from one system to another or used for any purpose other than to benefit the participants of each system.

The Retirement Systems issue financial reports, which are publicly available and include the basic financial statements, the required trend information, and any other required supplementary information. These reports may be obtained by written request to the corresponding retirement system administrator at the addresses detailed in note 1.

(a) ERS

Plan Description

The System is a cost-sharing multi-employer defined benefit plan sponsored by the Commonwealth. ERS was created under Act No. 447 (the Act), approved on May 15, 1951, as amended and became effective on January 1, 1952. ERS covers substantially all full-time employees of: (1) the Commonwealth's primary government and (2) certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own retirement systems. Appointed and temporary Commonwealth employees become plan members upon their date of employment. Plan members are eligible for a retirement annuity upon reaching the following age:

Police and Firemen	Other employees
50 with 25 years of credited services	55 with 25 years of credited services
58 with 10 years of credited services	58 with 10 years of credited services

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service.

On the coordinated plan, a participating employee contributes a 5.775% of the monthly salary for the first \$550 and 8.275% for the excess over \$550. By the time the employee reaches 65 years of age and begins to receive Social Security benefits, the pension benefits are reduced by the following:

- \$165 per month if retired with 55 years of age and 30 years of credited service
- \$110 per month if retired with less than 55 years of age and 30 years of credited service
- All other between \$82 and \$100 per month
- Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases are reduced over \$165 per month.

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On the noncoordinated plan, the participating employee contributes 8.275% of the monthly salary and does not have any change on the pension benefits upon receipt of Social Security benefits.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for minor, or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of death. If no spouse survives, or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of their studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death are paid. Under the postretirement benefit, the beneficiary with a surviving spouse age 60 or over and child 18 or under receive up to 50% (60%, if not covered under Title II of the Social Security Act) of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

On September 24, 1999, an amendment to the Act, which created ERS, was enacted to establish a defined contribution plan known as System 2000.

System 2000 became effective on January 1, 2000. Employees participating in the defined benefit plan system at December 31, 1999, had the option to either stay in the defined benefit plan or transfer to System 2000. Persons employed on or after January 1, 2000, are only allowed to become members of System 2000.

System 2000 is a hybrid defined-contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of plan assets, which will be invested by ERS, together with those of the defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which assumes that each year the participants' contributions (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Notes; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The sponsors' contributions (9.275% of the participants' salary) will be used to fund the defined benefit plan.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the original plan on or after January 1, 2000.

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Funding Policy

Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Commonwealth and other sponsors	9.275% of applicable payroll
Participants:	
Hired on or before March 31, 1990	5.775 of monthly gross salary up to \$550
	8.275 of monthly gross salary in excess of \$550
Hired on or after April 1, 1990	8.275 of monthly gross salary

(b) JRS

Plan Description

The JRS is a single-employer defined benefit plan, which is also administered by the ERS. The system was created under Act No. 12, approved on October 19, 1954. Membership is made up of all judges of the Judiciary Branch of the Commonwealth.

The system provides retirement as well as death and disability benefits. Benefits vest after 10 years of service and upon reaching 60 years of age.

Retirement benefits are determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the last month of compensation. The retirement annuity, for which the plan participant is eligible, is limited to a minimum of 25% and a maximum of 75% of the average compensation, except for judges of the Supreme Court for whom the annuity is limited to a minimum of 50% and a maximum of 100% of the average compensation.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for each child, minor, or student, up to a maximum benefit per family of 75% of the participating employee's salary at the date of death. If no spouse survives or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of their studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death is paid. Under the postretirement benefit, the beneficiary with surviving spouse age 60 or over and child 21 or under receive up to 60% of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$500.

During 1997, JRS enacted Act No. 177, which provides, effective January 1, 1999, for increases of 3% every three years of the pension benefits paid by JRS to those plan participants with three or more years of retirement.

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Funding Policy

All participants are required to make contributions to the plan equal to 8% of the applicable payroll. The Commonwealth, as sponsor, must contribute 20% of the applicable payroll. Contributions are established by law and are not actuarially determined.

(c) TRS

Plan Description

The TRS is a single-employer defined benefit plan sponsored by the Commonwealth. All active teachers of the Department of Education of the Commonwealth are covered by the system under the terms of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951. Licensed teachers working in private schools may also participate in the system as long as the required employer and employee contributions are satisfied.

The plan provides retirement, death, and disability benefits. Benefits vest after completion of a given number of years of credited service based on age. Benefits are determined by the application of stipulated benefit ratios to the members' average compensation. Average compensation is computed based on the highest three years of compensation recognized by TRS.

The annuity for which a plan member is eligible is limited to a minimum of \$300 per month and a maximum of 75% of the average compensation.

Funding Policy

Effective January 27, 2000, participant contributions were increased to 9% of their compensation, as provided by Act No. 45 of 2000. The Commonwealth, as sponsor, matches the participants' contributions at a rate of 8.5% of the applicable payroll. Contribution rates are established by law and are not actuarially determined.

Other relevant information on the Commonwealth's Retirement Systems is presented below (as of July 1, 2003, for JRS and ERS, and July 1, 2004 for TRS, for latest valuation date):

Membership

	ERS	JRS	TRS	Total
Retirees and beneficiaries				
currently receiving benefits	88,518	338	27,944	116,800
Current employees	161,947	336	51,026	213,309
Total	<u>250,465</u>	<u>674</u>	<u>78,970</u>	<u>330,109</u>

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Annual Pension Cost and Net Pension Obligation (Asset)

The Commonwealth's annual pension cost and net pension obligation (asset) of the three pension plans for the year ended June 30, 2005, were as follows (expressed in thousands):

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>	<u>Total</u>
Annual required contributions \$	578,387	8,707	220,821	807,915
Interest on net pension obligation (asset)	284,347	(1,262)	40,037	323,122
Adjustment to annual required sponsors' contributions	<u>(210,482)</u>	<u>935</u>	<u>(39,409)</u>	<u>(248,956)</u>
Annual pension cost	652,252	8,380	221,449	882,081
Statutory sponsors' contributions made	<u>(389,554)</u>	<u>(6,470)</u>	<u>(181,740)</u>	<u>(577,764)</u>
Increase in net pension obligation	262,698	1,910	39,709	304,317
Net pension obligation (asset) at beginning of year	<u>3,652,617</u>	<u>(12,021)</u>	<u>524,770</u>	<u>4,165,366</u>
Net pension obligation (asset) at end of year \$	<u><u>3,915,315</u></u>	<u><u>(10,111)</u></u>	<u><u>564,479</u></u>	<u><u>4,469,683</u></u>

The net pension obligation for ERS and TRS, and the net pension asset of JRS of \$4,480 million and \$10 million, respectively, are recorded in the accompanying statement of net assets.

The annual required contribution was determined by actuarial valuations for each of the pension plans as described below:

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Date of latest actuarial valuation	July 1, 2003	July 1, 2003	July 1, 2004
Actuarial-cost method	Projected unit credit cost	Projected unit credit cost	Entry age normal
Amortization method	Level percentage of pay	Level percentage of payroll	Level percentage closed 5% payroll increase per year
Remaining amortization period	23 years	23 years	16 years
Amortization approach	Closed	Closed	Closed

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June 30, 2005

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Asset-valuation method	Market value	Market value	Market value
Actuarial assumptions:			
Inflation	3.5%	3.5%	3.5%
Investment rate of return	8.5	8.5	8.0
Projected salary increases per annum	5.0	5.0	5.0
Cost-of-living adjustments	None	None	None

Three-Year Trend Information

The three-year trend information is as follows (amounts expressed in thousands):

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Annual pension cost (APC):			
Year ended June 30, 2005	\$ 652,252	8,380	221,449
Year ended June 30, 2004	652,252	8,380	219,168
Year ended June 30, 2003	860,082	6,464	176,237
Percentage of APC contributed:			
Year ended June 30, 2005	59.7%	77.2%	82.1%
Year ended June 30, 2004	52.9	66.3	68.9
Year ended June 30, 2003	38.4	85.6	70.4
Net pension obligation (asset):			
Year ended June 30, 2005	\$ 3,915,315	(10,111)	564,479
Year ended June 30, 2004	3,652,617	(12,021)	524,770
Year ended June 30, 2003	2,815,576	(15,773)	404,474

Schedule of Funding Progress (Required Supplementary Information – Unaudited)

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (amounts expressed in thousands):

Actuarial valuation date	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered Payroll	UAAL as a percentage of covered payroll
July 1, 2003	\$ 1,947,000	\$ 11,191,000	\$ 9,244,000	17%	\$ 3,334,000	277%
July 1, 2001	2,429,000	9,881,000	7,452,000	25	2,549,000	292
July 1, 2000	2,042,000	9,459,000	7,418,000	22	2,463,000	301

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Notes to Basic Financial Statements

June 30, 2005

The Puerto Rico Judiciary Retirement System (amounts expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered Payroll	UAAL as a percentage of covered payroll
July 1, 2003	\$ 67,800	\$ 166,700	\$ 105,000	41%	\$ 25,700	408%
July 1, 2001	70,100	162,200	92,100	43	26,700	345
July 1, 2000	82,800	135,800	53,000	61	25,700	206

Puerto Rico System of Annuities and Pensions for Teachers (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered Payroll	UAAL as a percentage of covered payroll
July 1, 2004	\$ 2,403,000	\$ 4,702,000	\$ 2,299,000	51%	\$ 1,294,000	178%
July 1, 2003	2,143,000	4,540,000	2,397,000	47	1,195,000	201
July 1, 2002	2,167,000	4,155,000	1,988,000	52	991,000	201

On August 12, 2000, Act No. 174 was approved to allow certain ERS participants to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation, which is computed based on the highest 36 months of compensation recognized by ERS. In these cases, the sponsor is responsible for contributing to ERS amounts to cover the benefit payments and the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

(20) Subsequent Events

Primary Government

On December 22, 2004, the Commonwealth issued tax and revenue anticipation notes amounting to \$1,042 million for the purpose of funding a portion of the projected cash flow requirements of the general fund in fiscal year 2006, which requirements result from timing differences between expected disbursements and receipts of taxes and other revenue. The notes are due on July 28, 2006, and bear an annual interest rate of 4.50%.

Component Units

(a) GDB

On February 8, 2006, GDB issued \$885 million of 2006 Series A senior notes for the purpose of replacing other higher cost funding sources and increasing its investments portfolio, among other uses. The notes bear an annual interest rate of 5.85%.

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Notes to Basic Financial Statements

June 30, 2005

(b) UPR

On November 19, 2005, the Board of Trustees of UPR approved a Resolution (Certification No. 43 2005 – 2006) authorizing the execution and delivery of separate Master Agreements, refunding a portion of its bonds and also simultaneously issuing bond (New Money) to defray the cost of certain necessary capital improvements at the UPR.

(c) PRHTA

On October 4, 2005, PRHTA issued Transportation Revenues Bonds (Series K) and Transportation Revenue Refunding Bonds (Series L) for the amount of \$800 million and \$598.2 million, respectively, for the purpose of financing various highway projects and refunding certain of the PRHTA's Transportation Revenues Bonds. Also, PRHTA issued Highway Revenue Refunding Bonds (Series BB) amounting to \$101.6 million for the purpose of refunding certain of the PRHTA's Highway Revenue Bonds.

(d) PREPA

On November 15, 2005, PREPA and GDB entered into an agreement for a line of credit of \$200 million to be used for interim financing for a portion of the costs associated with various capital improvement projects.

On October 31, 2005, PREPA, GDB and certain banks entered into an agreement for a revolving line of credit to be used for financing fuel purchases. Under the agreement, PREPA borrowed \$50 million.

(e) PRASA

Subsequent to June 30, 2005, PRASA entered into a line-of-credit agreement with GDB for \$100 million to finance its operations. Also, PRASA entered into a negotiation process to receive certain facilities that were previously administered and financed by PRIFA. The Commonwealth announced its intention of reducing significantly the financial assistance provided to PRASA commencing in fiscal year 2006. To mitigate the effect of such elimination or reduction in the financial support, PRASA has implemented a gradual increase process in the water and sewer rates. The first rate increase became effective on October 10, 2005. Another rate increase is scheduled for July 1, 2006.

(f) MFA

On December 9, 2005, MFA issued \$730.8 million of Puerto Rico Municipal Finance Agency \$413.1 million Series A Bonds, \$59.1 million Series B Refunding Bonds, and \$258.6 million Series C Refunding Bonds. The Series A Bonds are being issued to provide funds for the purchase by MFA from GDB of general obligation bonds and notes of various municipalities of Puerto Rico. The 2005 Series B Refunding Bonds are being issued to provide funds that will be used, together with other available moneys to refund some of the outstanding 1997 Series A Bonds of MFA. The 2005 Series C Refunding Bonds are being issued to provide funds that will be used, together with other available moneys for the purpose of providing funds that will be used together with other available moneys, to

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refund some of the outstanding 1999 Series A Bonds and 1999 Series B Refunding Bonds of MFA. The bonds are subject to redemption prior to the maturity dates as set forth in the related bond offering document, the earliest possible date of redemption being August 1, 2015, and bear interest rates ranging from 3.60% to 5%.

(21) Debt Service Deposit Agreements

On May 26, 2005 (but effective on July 1, 2005), the Commonwealth, PFC, and GDB (together the Commonwealth) and Lehman Brothers Special Financing Inc. (Lehman) entered into Debt Service Deposit Agreements (DSD Agreements), the objective of which was for the Commonwealth to secure an upfront payment in exchange for granting Lehman the rights to earnings generated from eight of its debt service funds. Seven of the funds are associated with the Commonwealth's PFC bonds, presented in the accompanying basic financial statements as Commonwealth appropriation bonds, and one fund is associated with the Commonwealth's general obligation bonds. The upfront payment, which amounted to \$82.7 million was received on May 26, 2005 and equaled the present value of the projected earnings income adjusted for credit timing risks as well as an appropriate amount of compensation for Lehman.

With the upfront payment made as explained above, the Commonwealth will now deliver to Lehman the required and scheduled debt service deposits and Lehman will deliver qualified government debentures which will mature before the next debt service payment date at an amount approximating such next debt service payment. Lehman will attempt to earn sufficient funds on the debt service deposit amounts, less their cost for the qualified government debentures, to make back the \$82.7 million over time. At the same time, the Commonwealth will be managing its borrowings and investments by increasing the predictability of its cash flows from earnings on its investments and not for purpose of speculation. The Commonwealth acknowledges that in exchange for the upfront payment received, it is foregoing its right to receive investment earnings on the deposit amounts referred to above in the future and that by accepting the upfront payment, the Commonwealth has minimized the risks resulting from fluctuations in interest rates during the term of the DSD Agreements but also has foregone the possibility of receiving greater returns on such amounts from such fluctuations.

Under the DSD Agreements, the Commonwealth will be exposed to the payment to Lehman of a Termination Amount, as defined in the agreement, principally upon the occurrence of redemption or a defeasance of the related bonds on or prior to the last scheduled deposit date. The amount of the Termination Amount will vary depending on various market conditions, as defined in the DSD Agreements. Under certain market conditions the Termination Amount owed to Lehman by the Commonwealth may exceed the amount of the original upfront payment received.

The \$82.7 million upfront payment received by the Commonwealth has been recognized as other revenue for budgetary purposes; however, under generally accepted accounting principles, such upfront payment is to be deferred and recognized proportionally over the future periods the Commonwealth would have otherwise earned such interest earnings. As the effective date of DSD Agreements is July 1, 2005, all of the \$82.7 million upfront payment received has been recorded as deferred revenue in the accompanying fund and government-wide financial statements.

**COMBINING, INDIVIDUAL FUND
FINANCIAL STATEMENTS AND SCHEDULES**

GENERAL FUND

The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Following is the supplemental schedule of expenditures – budget and actual – general fund.

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Supplemental Schedule of Expenditures by Agency—Budget and Actual—
Statutory Basis—General Fund

Year ended June 30, 2005
(In thousands)

	<u>Original budget</u>	<u>Final budget</u>	<u>Actual</u>	<u>Variance</u>
Expenditures:				
Current:				
General government:				
Senate of Puerto Rico	\$ 40,660	40,666	40,514	152
House of Representatives of Puerto Rico	48,969	48,973	53,377	(4,404)
Comptroller's Office	41,088	41,088	41,543	(455)
Governor's Office	5,944	5,717	6,092	(375)
Office of Management and Budget	27,901	27,837	43,696	(15,859)
Planning Board	13,717	13,706	13,621	85
Constructions and Land Subdivisions Appeals Board	1,548	1,524	1,578	(54)
Department of State	11,839	11,765	14,494	(2,729)
Department of the Treasury	160,989	160,989	174,040	(13,051)
Central Office of Personnel Administration	6,730	6,778	6,848	(70)
Commonwealth Elections Commission	39,810	39,810	61,944	(22,134)
Federal Affairs Administration	10,381	10,244	11,065	(821)
General Services Administration	2,554	2,554	3,333	(779)
Municipal Complaints Hearing Commission	4,957	4,861	4,727	134
Civil Rights Commission	1,213	1,213	1,218	(5)
Office of the Citizen's Ombudsman	3,981	3,981	3,904	77
Commission of Appeals of the Human Resources System	1,688	1,671	1,729	(58)
Rules and Permits Administration	4,197	4,165	4,437	(272)
Commonwealth's Commission to Settle Municipal Complaints	264	228	259	(31)
Legislative Affairs Office	975	975	246	729
Commission for the Public Service Work Relations	2,322	2,303	2,335	(32)
Government Ethics Board	9,508	9,508	9,508	—
Legislative Affairs Office	11,187	11,187	10,382	805
Office of the Superintendent of the Capitol	10,218	10,218	10,356	(138)
Comptroller's Special Reports Joint Commission	684	684	694	(10)
Legislative Donation Commission	950	950	650	300
Coordination Office for Special Communities of Puerto Rico	8,782	8,732	8,689	43
Public Affairs	6,543	5,628	6,188	(560)
Governor's Secretary Office	13,132	13,149	14,125	(976)
Total general government	<u>492,731</u>	<u>491,104</u>	<u>551,592</u>	<u>(60,488)</u>
Public safety:				
Puerto Rico General Court of Justice	255,849	255,849	272,124	(16,275)
State Civil Defense Agency	7	7	5	2
Commission of Investigation, Processing, and Appeals Board	818	798	859	(61)
Department of Justice	144,277	143,529	133,644	9,885
Puerto Rico Police Department	784,670	780,213	793,703	(13,490)
Puerto Rico Firefighters Corps	63,372	62,926	63,110	(184)
Puerto Rico National Guard	11,418	11,196	11,313	(117)
Public Service Commission	10,715	10,714	10,737	(23)
Consumer Affairs Department	14,333	14,284	14,443	(159)
Juvenile Institutions Administration	84,217	83,962	88,032	(4,070)
Corrections Administration	374,699	374,629	398,277	(23,648)
Department of Correction and Rehabilitation	4,927	4,997	16,168	(11,171)
Natural Resources Administration	37,767	37,268	43,832	(6,564)
Parole Board	3,506	3,306	3,341	(35)
Forensic Sciences Institute	12,331	12,298	12,298	—
Special Prosecutor Panel	2,036	2,036	2,036	—
Pre-Trial Services Office	5,819	5,790	6,227	(437)
Correctional Health	86,815	86,776	91,275	(4,499)
Medical Emergencies Service	19,573	19,573	31,737	(12,164)
Criminal Justice University College	—	1,268	1,268	—
Total public safety	<u>\$ 1,917,149</u>	<u>1,911,419</u>	<u>1,994,429</u>	<u>(83,010)</u>

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency—Budget and Actual—
Statutory Basis—General Fund

Year ended June 30, 2005

(In thousands)

	Original budget	Final budget	Actual	Variance
Health:				
Environmental Quality Board	\$ 11,054	11,361	11,361	—
Department of Health	205,494	215,719	271,704	(55,985)
Mental Health and Drug Addiction Services Administration	104,185	104,185	129,348	(25,163)
Drug Control	3,773	2,166	2,146	20
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	2,000	2,000	4,000	(2,000)
Solid Waste Authority of Puerto Rico	6,379	6,346	6,396	(50)
Puerto Rico Health Insurance Administration	989,513	989,496	990,807	(1,311)
Total health	1,322,398	1,331,273	1,415,762	(84,489)
Public housing and welfare:				
Youth Affairs Office	3,904	3,795	4,846	(1,051)
Rural Housing Administration	9,341	9,275	9,295	(20)
Puerto Rico Volunteers Service Corps	13,503	13,470	13,386	84
Department of Labor and Human Resources	7,526	7,492	49,488	(41,996)
Labor Relations Board	1,425	1,403	1,410	(7)
Department of Housing	10,992	10,955	11,229	(274)
Department of Recreation and Sports	53,106	52,985	53,504	(519)
Administration for the Horse Racing Sport and Industry	3,435	3,419	3,708	(289)
Women's Affairs Commission	5,645	5,628	4,703	925
Office of the Veteran's Ombudsman	1,735	1,692	2,685	(993)
Department of Family	43,562	43,114	56,967	(13,853)
Family and Children Administration	131,197	131,220	140,499	(9,279)
Child Support Administration	10,782	10,681	10,882	(201)
Vocational Rehabilitation Administration	18,293	18,293	18,310	(17)
Social Economic Development Administration	95,874	95,959	96,164	(205)
Office of the Disabled Persons Ombudsman	3,187	3,185	3,222	(37)
Office for Elderly Affairs	3,754	3,754	2,480	1,274
Communities Rehabilitation Administration	6,049	6,015	5,952	63
Patient Ombudsman	5,273	5,256	5,256	—
Office of the General Auditor-Department of Family	550	294	294	—
Institutional Trust of the National Guard of Puerto Rico	495	24	—	24
Right to Employment Administration	14,684	14,651	35,651	(21,000)
Cantera's Peninsula Integral Development Company	192	192	192	—
Puerto Rico Housing Finance Authority	380	380	380	—
Industries for the Blind, Mentally Retarded, and Other				
Disabled Persons of Puerto Rico	141	141	141	—
Puerto Rico Infrastructure Financing Authority				
Administration for the Care and Development of the Childhood	4,146	3,896	3,034	862
Total public housing and welfare	449,171	447,169	533,678	(86,509)
Education:				
Department of Education	1,992,957	1,993,659	2,397,018	(403,359)
State Office for Historic Preservation	2,063	2,562	2,329	233
General Education Council	2,029	1,988	2,028	(40)
Athenaeum of Puerto Rico	500	500	500	—
Institute of Puerto Rico Culture	33,665	33,615	33,606	9
Plastic Arts School	3,127	3,055	3,335	(280)
University of Puerto Rico	747,804	747,804	747,554	250
Musical Arts Corporation	7,488	7,471	7,471	—
Fine Arts Center Corporation	3,422	3,405	3,405	—
Puerto Rico Public Broadcasting Corporation	21,421	21,388	21,388	—
Puerto Rico Conservatory of Music Corporation	4,407	4,374	4,374	—
Puerto Rico Higher Education Council	28,353	28,336	28,336	—
Total education	\$ 2,847,236	2,848,157	3,251,344	(403,187)

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency—Budget and Actual—
Statutory Basis—General Fund

Year ended June 30, 2005
(In thousands)

	Original budget	Final budget	Actual	Variance
Economic development:				
Vieques Commissioner's Office	\$ 851	783	784	(1)
Department of Transportation and Public Works	71,133	71,068	71,764	(696)
Department of Natural and Environmental Resources	4,085	4,478	3,846	632
Department of Agriculture	23,864	22,554	22,081	473
Department of Economic Development and Commerce	5,724	5,705	5,705	—
Cooperative Enterprises Development Administration	3,727	3,638	3,638	—
Cooperative Enterprises Inspector's Office	848	822	823	(1)
Rural Development Corporation	4,277	4,237	4,225	12
Department of Economic Development and Commerce	3,986	4,089	3,810	279
Energy Affairs Administration	170	170	170	—
Culebra Conservation and Development Authority	795	795	795	—
Puerto Rico Infrastructure Financing Authority	392	392	70,392	(70,000)
Puerto Rico Aqueduct and Sewer Authority	123,291	123,291	123,286	5
Puerto Rico Industrial Development Company	35,333	35,300	35,300	—
Puerto Rico Electric Power Authority	6,335	6,335	6,328	7
Government Development Bank for Puerto Rico	114,264	114,264	42,966	71,298
Puerto Rico Metropolitan Bus Authority	479	479	479	—
Puerto Rico Maritime Transportation Authority	15,500	15,500	15,500	—
Tourism Company of Puerto Rico	5,131	5,131	5,131	—
Agricultural Services and Development Administration	82,980	84,255	84,255	—
National Parks Company of Puerto Rico	14,522	14,522	14,507	15
Puerto Rico Land Authority	1,852	1,852	1,852	—
Corporation for the Development of the Film Industry in Puerto Rico	1,868	1,812	1,812	—
Puerto Rico Land Administration	4,211	4,211	4,211	—
Port of the Americas Authority	3,700	3,700	3,700	—
Puerto Rico Trade and Export Corporation	4,100	4,100	14,050	(9,950)
Corporation for the Development of Caño Martín Peña	500	500	500	—
Authority for Redevelopment of Roosevelt Roads	500	—	—	—
Total economic development	534,418	533,983	541,910	(7,927)
Intergovernmental:				
CRIM	—	—	16,558	(16,558)
Municipal Service Administration	381,610	381,608	409,382	(27,774)
Total intergovernmental	381,610	381,608	425,940	(44,332)
Debt service:				
Principal	70,518	70,518	80,633	(10,115)
Interest and other	112,657	112,657	112,946	(289)
Total expenditures	\$ 8,127,888	8,127,888	8,908,234	(780,346)
Transfer-out to other funds:				
Office of Management and Budget	\$ 85,127	85,127	85,127	—
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	178,724	178,724	178,058	666
Teachers' Pensions Board	61,813	61,813	60,853	960
Contributions to Political Parties	900	900	900	—
Office for the Improvements of Public Schools	5,315	5,315	5,315	—
Puerto Rico Maritime Shipping Authority	5,272	5,272	5,224	48
Public Buildings Authority	10,003	10,003	10,003	—
Public Housing Administration	1,574	1,574	2,465	(891)
Budgetary Fund	—	—	15,400	(15,400)
Emergency Fund	—	—	43,689	(43,689)
Voluntary Elections Fund	—	—	24,379	(24,379)
Department of Treasury—Transfer to debt service	377,384	377,384	377,384	—
Total operating transfers-out to other funds	\$ 726,112	726,112	808,797	(82,685)

NONMAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specific purposes.

Public Buildings Authority Special Revenue Fund: The operating fund of a blended component unit used to account for the operation, maintenance, equipment replacement and other extraordinary operation and maintenance costs of the buildings and facilities that, when constructed, are leased to the Commonwealth primary government agencies.

Debt Service Funds

The debt service funds are used to account for the accumulation of resources predominantly for, and the payment of, general long-term bonds principal, interest and related costs other than bonds payable from operations of proprietary fund types, pension trust funds and discretely presented component units. Long-term debt and interest due on July 1 of the following year are accounted as a fund liability if resources are available as of June 30 for its payment.

The Children's Trust Debt Service Fund: The debt service fund of The Children's Trust (a blended component unit) accounts for the accumulation of resources for payment of interest and principal on long-term obligations financed with moneys to be received by the Commonwealth from the global settlement agreement signed by certain tobacco companies.

Public Buildings Authority Debt Service Fund: A blended component unit engaged in the construction and/or acquisition of building facilities for lease mainly to the Commonwealth's primary government agencies. Its debt service fund is used to account for the accumulation of resources for the payment of revenue bonds and other liabilities incurred to finance the construction of the buildings and facilities.

Puerto Rico Maritime Shipping Authority Debt Service Fund: This is the remainder of a former shipping company owned by the Commonwealth. Its debt service fund is used to account for the accumulation of resources for the payment of the long-term liability that resulted from the sale of its marine operations. This fund is mainly subsidized from appropriations and operating transfers from the general fund.

Capital Project Funds

Capital project funds are used to account for the financial resources used for the acquisition or construction of major capital facilities not being financed by proprietary fund types, pension trust funds, and discretely presented component units.

Commonwealth Public Improvements Funds and Other Funds: These funds present the activities of the capital improvements program of the Commonwealth, financed with the proceeds of the general obligation bonds.

COMMONWEALTH OF PUERTO RICO
Combining Balance Sheet – Nonmajor Governmental Funds
June 30, 2005
(In thousands)

	Special revenue	Debt service			Capital projects		Total nonmajor governmental funds
	Public Buildings Authority	The Children's Trust	Public Buildings Authority	Puerto Rico Maritime Shipping Authority	Commonwealth of Puerto Rico	Total	
Assets							
Cash and cash equivalents in commercial banks	\$ 50,419	—	—	—	376,240	—	426,659
Cash and cash equivalents in component unit banks	—	—	—	2,338	14,881	2,338	17,219
Investments	—	114,744	—	695	—	115,439	115,439
Receivables:							
Accounts	13,548	—	—	—	671	—	14,219
Loans	—	—	—	—	36	—	36
Accrued interest	—	—	—	7	—	7	7
Due from:							
Other funds	60,272	—	25,635	—	30,765	25,635	116,672
Component units	37,899	—	—	—	—	—	37,899
Primary government	3,048	—	—	—	—	—	3,048
Restricted cash and cash equivalents	8	—	117,970	—	—	117,970	117,978
Real estate held for future development	—	—	—	—	793	—	793
Total assets	\$ 165,194	114,744	143,605	3,040	423,386	261,389	849,969
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	\$ 57,051	—	—	348	33,531	348	90,930
Due to component units	—	—	—	—	11,885	—	11,885
Bonds payable	—	—	46,150	—	10	46,150	46,160
Interest payable	—	—	66,110	—	—	66,110	66,110
Total liabilities	57,051	—	112,260	348	45,426	112,608	215,085
Fund balances:							
Reserved for encumbrances	—	—	—	—	45,546	—	45,546
Unreserved reported in:							
Debt service funds	—	114,744	31,345	2,692	—	148,781	148,781
Special revenue funds	108,143	—	—	—	—	—	108,143
Capital projects funds	—	—	—	—	332,414	—	332,414
Total fund balances	108,143	114,744	31,345	2,692	377,960	148,781	634,884
Total liabilities and fund balances	\$ 165,194	114,744	143,605	3,040	423,386	261,389	849,969

COMMONWEALTH OF PUERTO RICO
Combining Statement of Revenue, Expenditures, and Changes in
Fund Balances – Nonmajor Governmental Funds

Year ended June 30, 2005

(In thousands)

	Special revenue		Debt service		Capital projects		Total nonmajor governmental funds
	Public Buildings Authority	The Children's Trust	Public Buildings Authority	Puerto Rico Maritime Shipping Authority	Commonwealth of Puerto Rico	Total	
Revenue:							
Revenue from global tobacco settlement agreement	—	71,461	—	—	—	71,461	71,461
Interest and investment earnings	13,456	3,800	—	130	—	3,930	17,386
Other	10,261	—	—	—	—	—	10,261
Total revenue	23,717	75,261	—	130	—	75,391	99,108
Expenditures:							
Current:							
General government	147,128	—	—	—	195,463	—	342,591
Public safety	—	—	—	—	43,431	—	43,431
Health	—	—	—	—	4,924	—	4,924
Public housing and welfare	—	—	—	—	29,558	—	29,558
Education	—	—	—	—	127,971	—	127,971
Economic development	—	—	—	—	59,634	—	59,634
Capital outlays	—	—	—	232	113,401	232	59,866
Debt service:							
Principal	—	13,320	46,150	155	—	59,625	59,625
Interest and other	—	61,674	82,138	4,091	—	147,903	147,903
Debt issuance costs	—	—	—	—	6,058	—	6,058
Total expenditures	147,128	74,994	128,288	4,478	580,440	207,760	935,328
Excess (deficiency) of revenue over expenditures	(123,411)	267	(128,288)	(4,348)	(580,440)	(132,369)	(836,220)
Other financing sources (uses):							
Transfers in	114,262	—	153,716	4,246	33,383	157,962	305,607
Transfers out	—	(403)	—	—	(123,615)	(403)	(124,018)
Long-term debt issued	—	—	—	—	580,566	—	580,566
Total other financing sources (uses)	114,262	(403)	153,716	4,246	490,334	157,559	762,155
Net change in excess (deficiency) of revenue over expenditures and other financing sources (uses)	(9,149)	(136)	25,428	(102)	(90,106)	25,190	(74,065)
Fund balances, beginning of year	117,292	114,880	5,917	2,794	468,066	123,591	708,949
Fund balances, end of year	108,143	114,744	31,345	2,692	377,960	148,781	634,884

NONMAJOR PROPRIETARY FUNDS

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Disability Insurance: It was created by Act 139 on June 26, 1968. It is used to account for disability benefits to remedy temporarily the loss of income as a result of disability caused by sickness or accident unrelated to the employment.

Drivers' Insurance: It was created by Act 428 on May 15, 1950. It is used to account for contributions made by the drivers and their employers to provide a social security plan for the benefit of the drivers in Puerto Rico. The plan also includes payment of benefits for health and life insurance.

Puerto Rico Water Pollution Control Revolving Fund: It was created by Act No. 44 on June 21, 1988, as amended. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Environmental Quality Board (EQB). Pursuant to such Act, EQB is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA) for lending activities.

Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund: It was created by Act No. 32 on July 7, 1997. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Department of Health (DOH). Pursuant to such act, DOH, on behalf of the Commonwealth, is authorized to enter into operating and capitalization grant agreements with the EPA for lending activities.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets –
Nonmajor Proprietary Funds

June 30, 2005

(In thousands)

	Business-type activities – nonmajor enterprise funds				
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving	Puerto Rico Safe Drinking Water Treatment Revolving Loan	Total
Assets					
Current assets:					
Cash and cash equivalents in commercial banks	\$ 85,870	37,231	—	—	123,101
Cash and cash equivalents in component unit banks	—	—	43,773	12,625	56,398
Accounts and loans receivable, net:					
Insurance premiums, net	3,993	1,099	—	—	5,092
Component units	—	—	9,343	327	9,670
Accrued interests	255	43	1,350	299	1,947
Other	184	31	92	—	307
Unrestricted investments	33,940	—	—	—	33,940
Total current assets	124,242	38,404	54,558	13,251	230,455
Noncurrent assets:					
Loans receivable, excluding current portion, net:					
Component units	—	—	118,178	27,645	145,823
Intergovernmental	—	—	1,906	—	1,906
Total assets	124,242	38,404	174,642	40,896	378,184
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued liabilities	3,306	677	800	507	5,290
Deferred revenue	—	29	—	—	29
Compensated absences	726	434	—	—	1,160
Insurance benefits payable	896	299	—	—	1,195
Total current liabilities	4,928	1,439	800	507	7,674
Noncurrent liabilities – compensated absences	421	437	—	—	858
Total liabilities	5,349	1,876	800	507	8,532
Net assets:					
Restricted for:					
Payment of insurance benefits	118,893	36,528	—	—	155,421
Capital projects	—	—	173,842	40,389	214,231
Total net assets	\$ 118,893	36,528	173,842	40,389	369,652

COMMONWEALTH OF PUERTO RICO
Combining Statement of Revenue, Expenses, and Changes in Net Assets –
Nonmajor Proprietary Funds
Year ended June 30, 2005
(In thousands)

	Business-type activities – nonmajor enterprise funds				
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving	Puerto Rico Safe Drinking Water Treatment Revolving Loan	Total
Operating revenue:					
Insurance premiums	\$ 48,560	5,314	—	—	53,874
Interest	1,721	337	3,146	741	5,945
Total operating revenue	50,281	5,651	3,146	741	59,819
Operating expenses:					
Disability and drivers insurance benefits	4,785	1,118	—	—	5,903
General, administrative and other operating expenses	20,591	4,917	433	593	26,534
Total operating expenses	25,376	6,035	433	593	32,437
Operating income (loss)	24,905	(384)	2,713	148	27,382
Nonoperating revenue:					
Contributions from federal government	—	—	7,150	303	7,453
Income (loss) before transfers	24,905	(384)	9,863	451	34,835
Transfers from general fund	—	—	1,416	20	1,436
Net change in net assets	24,905	(384)	11,279	471	36,271
Net assets, beginning of year	93,988	36,912	162,563	39,918	333,381
Net assets, end of year	\$ 118,893	36,528	173,842	40,389	369,652

COMMONWEALTH OF PUERTO RICO

Combining Statement of Cash Flows –
Nonmajor Proprietary Funds

Year ended June 30, 2005

(In thousands)

	Business-type activities – nonmajor enterprise funds				Total
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving	Puerto Rico Safe Drinking Water Treatment Revolving Loan	
Cash flows from operating activities:					
Receipts from customers and users	\$ 47,074	5,277	10,445	1,418	64,214
Payments to suppliers and employees	(22,855)	(4,398)	(9,228)	(974)	(37,455)
Payments of insurance benefits	(4,909)	(1,073)	—	—	(5,982)
Net cash provided by (used in) operating activities	19,310	(194)	1,217	444	20,777
Cash flows from noncapital financing activities:					
Intergovernmental grants and contributions	—	—	7,150	303	7,453
Transfers from general fund	—	—	1,416	20	1,436
Net cash provided by noncapital financing	—	—	8,566	323	8,889
Cash flows from investing activities:					
Interests received on deposits and investments	1,797	301	—	—	2,098
Other investment income received	201	—	—	—	201
Net cash provided by investing activities	1,998	301	—	—	2,299
Net increase in cash and cash equivalents	21,308	107	9,783	767	31,965
Cash and equivalents, beginning of year	64,562	37,124	33,990	11,858	147,534
Cash and cash equivalents, end of year	\$ 85,870	37,231	43,773	12,625	179,499
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:					
Operating income (loss)	\$ 24,905	(384)	2,713	148	27,382
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Decrease (increase) in accounts and loans receivable	(1,486)	(37)	(1,700)	25	(3,198)
Interests earned on deposits, loans and investments	(1,721)	(337)	—	—	(2,058)
Changes in operating assets and liabilities:					
Decrease in deferred revenue	—	(33)	—	—	(33)
Increase in compensated absences	127	122	—	—	249
Increase (decrease) in liability for insurance benefits payable	(124)	222	—	—	98
Increase (decrease) in accounts payable and accrued liabilities	(2,391)	253	204	271	(1,663)
Total adjustments	(5,595)	190	(1,496)	296	(6,605)
Net cash provided by (used in) operating activities	\$ 19,310	(194)	1,217	444	20,777

FIDUCIARY FUNDS

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, organizations, and other governmental units. Following are the Commonwealth's fiduciary funds:

Pension Trust Funds

The pension trust funds are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees of the Commonwealth.

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS): ERS is the administrator of a defined-benefit pension plan which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their retirement systems. On September 24, 1999, an amendment to the Law that created ERS was enacted with the purpose of establishing a new defined contribution pension plan (System 2000) for persons joining the government on or after January 1, 2000.

Puerto Rico System of Annuities and Pensions for Teachers (TRS): TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education. TRS provides retirement, death, and disability benefits.

Puerto Rico Judiciary Retirement System (JRS): JRS is administered by the ERS and covers all individuals holding a position as Justice of the Supreme Court, Judge of the former Superior Court, Judge of District Court, or the Municipal Judges of the Commonwealth. The system provides retirement as well as death and disability benefits.

Agency Fund

Agency fund is used to account for assets held by the Commonwealth as an agent for individuals, private organizations, and other governments. This fund is custodial in nature (assets equal liabilities) and does not involve measurement of the results of operations.

Special Deposits: This fund acts in a fiduciary capacity in order to account for moneys received with specified purposes for which the law does not specify its recording in any other fund. It mainly includes deposits under the custody of the courts of justice for alimony payments.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Fiduciary Net Assets – Pension Trust Funds

June 30, 2005

(In thousands)

	Pension Trust Funds			
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	Totals
Assets				
Cash and cash equivalents in commercial banks:				
Unrestricted	\$ 13,196	79,017	1,804	94,017
Restricted	—	4,448	—	4,448
Cash and cash equivalents in component unit banks:				
Unrestricted	29,177	3,536	95	32,808
Restricted	1,578	—	—	1,578
Investments:				
Debt and equity securities, at fair value	1,366,572	2,090,198	69,391	3,526,161
Investment in PRTA Holdings, at appraised value	486,080	—	—	486,080
Other	41,244	44,747	—	85,991
Receivables, net:				
Accounts	40,695	—	—	40,695
Loans and advances	465,247	345,278	251	810,776
Accrued interests and dividends	2,209	4,449	257	6,915
Due from (to) other pension trust funds	1,376	—	(1,376)	—
Due from general fund of the Commonwealth	17,513	—	—	17,513
Other	21,896	13,109	147	35,152
Capital assets, net	8,411	26,206	—	34,617
Other assets	7,764	600	—	8,364
Total assets	2,502,958	2,611,588	70,569	5,185,115
Liabilities				
Accounts payable and accrued liabilities	37,087	29,160	772	67,019
Repurchase agreements	138,000	—	—	138,000
Bonds payable	—	21,285	—	21,285
Due to component unit	—	4	—	4
Total liabilities	175,087	50,449	772	226,308
Net Assets				
Net assets held in trust for pension and other benefits	\$ 2,327,871	2,561,139	69,797	4,958,807

COMMONWEALTH OF PUERTO RICO
Combining Statement of Changes in Fiduciary Net Assets – Pension Trust Funds
Year ended June 30, 2005
(In thousands)

	Pension Trust Funds			
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	Totals
Additions:				
Contributions:				
Sponsor	\$ 374,823	120,887	6,470	502,180
Participants	332,376	131,481	2,775	466,632
Special	14,731	60,853	—	75,584
Total contributions	<u>721,930</u>	<u>313,221</u>	<u>9,245</u>	<u>1,044,396</u>
Interests	49,917	47,577	1,160	98,654
Dividends	19,112	20,339	206	39,657
Net change in fair value of investments, including realized losses on sale and maturities of investments	186,643	161,685	4,248	352,576
Investment expenses	(3,750)	(4,986)	(197)	(8,933)
Net interest and investment income	<u>251,922</u>	<u>224,615</u>	<u>5,417</u>	<u>481,954</u>
Other income	<u>7,925</u>	<u>1,167</u>	<u>—</u>	<u>9,092</u>
Total additions	<u>981,777</u>	<u>539,003</u>	<u>14,662</u>	<u>1,535,442</u>
Deductions:				
Pension and other benefits	739,439	352,143	11,490	1,103,072
Refunds of contributions	19,681	2,912	—	22,593
General and administrative expenses	36,228	25,804	1,226	63,258
Total deductions	<u>795,348</u>	<u>380,859</u>	<u>12,716</u>	<u>1,188,923</u>
Net change in net assets held in trust for pension and other benefits	186,429	158,144	1,946	346,519
Net assets held in trust for pension and other benefits:				
Beginning of year	<u>2,141,442</u>	<u>2,402,995</u>	<u>67,851</u>	<u>4,612,288</u>
End of year	<u>\$ 2,327,871</u>	<u>2,561,139</u>	<u>69,797</u>	<u>4,958,807</u>

COMMONWEALTH OF PUERTO RICO

Combining Statement of Changes in Assets and Liabilities – Agency Fund

Year ended June 30, 2005

(In thousands)

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2005</u>
Assets				
Cash and cash equivalents in commercial banks	\$ 454,754	12,565	—	467,319
Cash and cash equivalents in component unit banks	97,769	2,990,607	2,978,274	110,102
Investments	22,999	—	6,884	16,115
Accounts receivable, net	21,421	15,457	36,878	—
Due from component units	2,014	—	2,014	—
Other assets	532	—	532	—
Total assets	<u>\$ 599,489</u>	<u>3,018,629</u>	<u>3,024,582</u>	<u>593,536</u>
Liabilities				
Accounts payable and accrued liabilities	<u>\$ 599,489</u>	<u>3,863,445</u>	<u>3,869,398</u>	<u>593,536</u>
Total liabilities	<u>\$ 599,489</u>	<u>3,863,445</u>	<u>3,869,398</u>	<u>593,536</u>

NONMAJOR COMPONENT UNITS

These entities are presented because the nature and significance of their relationship with the primary government are such that their exclusion would cause the basic financial statements to be misleading. These are discretely presented in a separate column in the basic financial statements due to nature of the services they provide. The accounting principles followed by each of the component units included herein may vary depending on the type of industries these are involved (that is, banking, construction, public utilities, and so forth). The detailed information for each of these entities may be obtained directly from the administrative offices of the corresponding entities, as described in note 1 to the basic financial statements included in the financial section of this report.

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

	State Insurance Fund Corporation	Economic Development Bank for Puerto Rico	Puerto Rico Municipal Finance Agency	Puerto Rico Ports Authority	Puerto Rico Industrial Development Company	Automobile Accident Compensation Administration
Assets						
Current assets:						
Cash and cash equivalents in commercial banks	\$ 1,107	1,510	—	996	15,083	6,297
Cash and cash equivalents in component unit banks	181,031	1,469	6,538	—	24,300	—
Investments, including collateral from securities lending transactions	644,511	288,081	182,048	—	—	223,797
Receivables, net:						
Insurance premiums	84,882	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—
Accounts	—	—	—	81,220	14,102	1,285
Loans and advances	—	53,401	—	—	1,668	—
Accrued interest	9,801	5,710	2	—	13,353	1,034
Other governmental entities	—	—	—	—	—	—
Other	17,773	—	—	—	—	1,807
Due from:						
Primary government	—	—	—	—	—	3,756
Component units	3,500	488	—	—	—	—
Inventories	7,537	—	—	435	—	—
Prepaid expenses	—	—	—	6,744	107	—
Total current assets	950,142	350,659	188,588	89,395	68,613	237,976
Noncurrent assets:						
Restricted assets:						
Cash and cash equivalents in commercial banks	—	—	80	59,707	91,907	129
Cash and cash equivalents in component unit banks	—	—	—	10,240	—	—
Investments and other restricted assets	—	—	1,397,154	—	—	—
Investments	702,745	460,777	—	1,000	4,422	—
Receivables:						
Loans, interest and other	—	92,221	—	—	3,699	—
Other governmental entities	—	—	—	—	—	—
Due from:						
Primary government	—	—	—	—	—	—
Component units	—	8,231	—	27,090	—	—
Property held for sale or future development	—	—	—	—	—	—
Capital assets not being depreciated	13,010	—	—	377,578	258,274	901
Capital assets, depreciable, net	105,796	10,993	—	341,812	474,825	7,888
Deferred expenses and other assets	—	5,529	—	2,493	4,343	2
Total noncurrent assets	821,551	577,751	1,397,234	819,920	837,470	8,920
Total assets	\$ 1,771,693	928,410	1,585,822	909,315	906,083	246,896

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

	Puerto Rico Land Administration	National Parks Company of Puerto Rico	Puerto Rico Medical Services Administration	Puerto Rico Trade and Export Company	Tourism Company of Puerto Rico	Cardiovascular Center Corporation of Puerto Rico and the Caribbean
Assets						
Current assets:						
Cash and cash equivalents in commercial banks	\$ 2,866	180	4,934	2,407	105,698	2,028
Cash and cash equivalents in component unit banks	49,148	6,660	—	4,547	—	—
Investments, including collateral from securities lending transactions	27,159	—	—	25,505	10,364	—
Receivables, net:						
Insurance premiums	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—
Accounts	2,980	1,599	9,661	638	10,421	18,133
Loans and advances	—	—	—	—	826	—
Accrued interest	1,685	—	—	126	—	—
Other governmental entities	3,234	23	26,677	261	—	—
Other	44	—	—	—	1,532	2,093
Due from:						
Primary government	—	—	24,404	—	—	—
Component units	1,305	—	—	—	—	—
Inventories	—	—	4,063	—	—	2,290
Prepaid expenses	—	539	—	647	4	472
Total current assets	88,421	9,001	69,739	34,131	128,845	25,016
Noncurrent assets:						
Restricted assets:						
Cash and cash equivalents in commercial banks	—	10,867	318	—	—	—
Cash and cash equivalents in component unit banks	442	31,269	—	—	—	2,880
Investments and other restricted assets	—	—	—	8,719	—	—
Investments	—	—	—	—	36,167	—
Receivables:						
Loans, interest and other	—	—	—	1,280	460	—
Other governmental entities	1,455	—	—	—	—	—
Due from:						
Primary government	—	—	—	—	—	—
Component units	5,223	—	—	—	—	—
Property held for sale or future development	144,080	—	—	—	—	—
Capital assets not being depreciated	23,246	24,541	15,843	64,661	12,778	3,313
Capital assets, depreciable, net	6,042	210,169	28,968	37,653	16,458	38,611
Deferred expenses and other assets	149	—	—	80	8,158	—
Total noncurrent assets	180,637	276,846	45,129	112,393	74,021	44,804
Total assets	\$ 269,058	285,847	114,868	146,524	202,866	69,820

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

	Assets	Agricultural Services and Development Corporation	Puerto Rico Land Authority	Puerto Rico Metropolitan Bus Authority	Puerto Rico Telephone Authority	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental, Control Facilities Financing Authority	Puerto Rico Solid Waste Authority
Current assets:							
Cash and cash equivalents in commercial banks	\$	12	3,837	911	—	—	—
Cash and cash equivalents in component unit banks		—	21,538	—	410	8,852	705
Investments, including collateral from securities lending transactions		—	—	—	—	—	—
Receivables, net:							
Insurance premiums		—	—	—	—	—	—
Intergovernmental		—	—	3,414	—	—	—
Accounts		6,750	9,589	—	—	—	1,514
Loans and advances		—	186	—	—	—	—
Accrued interest		—	277	—	—	76	—
Other governmental entities		8,910	1,458	—	—	—	—
Other		507	—	3,460	—	—	—
Due from:							
Primary government		—	5,537	—	—	—	—
Component units		—	16,931	—	—	—	—
Inventories		5,924	—	7,343	—	—	—
Prepaid expenses		359	—	—	—	—	69
Total current assets		22,462	59,353	15,128	410	8,928	2,288
Noncurrent assets:							
Restricted assets:							
Cash and cash equivalents in commercial banks		—	734	—	—	—	2,087
Cash and cash equivalents in component unit banks		118,696	391	42	16,156	—	15,659
Investments and other restricted assets		—	—	—	1,850	—	1,000
Investments		—	4,865	—	—	—	800
Receivables:							
Loans, interest and other		—	725	—	13	—	—
Other governmental entities		—	—	—	—	—	—
Due from:							
Primary government		—	—	—	—	—	—
Component units		—	—	—	—	—	—
Property held for sale or future development		—	—	—	—	—	—
Capital assets not being depreciated		8,330	81,197	2,569	—	—	41,252
Capital assets, depreciable, net		33,756	10,125	60,826	—	—	147,652
Deferred expenses and other assets		540	73	—	—	8	—
Total noncurrent assets		161,322	98,110	63,437	18,019	8	208,450
Total assets	\$	183,784	157,463	78,565	18,429	8,936	210,738

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Right to Employment Administration	Puerto Rico Broadcasting Corporation	Fine Arts Center Corporation	Puerto Rico Maritime Transportation Authority	Puerto Rico Council on Higher Education
Assets						
Current assets:						
Cash and cash equivalents in commercial banks	\$ —	—	2,526	1,417	110	—
Cash and cash equivalents in component unit banks	765	5,433	701	—	—	2,213
Investments, including collateral from securities pending transactions	87,905	—	—	856	—	—
Receivables, net:						
Insurance premiums	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—
Accounts	—	470	306	78	—	245
Loans and advances	—	—	—	—	—	—
Accrued interest	1,056	—	—	—	—	—
Other governmental entities	—	—	8	451	278	2,500
Other	243	—	230	—	—	—
Due from:						
Primary government	—	3,613	—	—	—	—
Component units	—	—	—	—	—	—
Inventories	—	—	—	—	39	—
Prepaid expenses	—	4	139	156	485	—
Total current assets	89,969	9,520	3,910	2,958	912	4,958
Noncurrent assets:						
Restricted assets:						
Cash and cash equivalents in commercial banks	—	—	3,238	—	—	—
Cash and cash equivalents in component unit banks	—	611	—	—	—	5,649
Investments and other restricted assets	—	—	—	1,212	—	—
Investments	32,308	—	—	—	—	—
Receivables:						
Loans, interest and other	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—
Due from:						
Primary government	—	—	—	—	—	—
Component units	—	—	—	—	—	—
Property held for sale or future development	—	—	—	—	—	—
Capital assets not being depreciated	—	—	9,845	3,029	12,945	—
Capital assets, depreciable, net	159	395	12,488	15,805	45,808	528
Deferred expenses and other assets	—	—	376	—	—	—
Total noncurrent assets	32,467	1,006	25,947	20,046	58,753	6,177
Total assets	\$ 122,436	10,526	29,857	23,004	59,665	11,135

(Continued)

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

Assets		Farm Insurance Corporation of Puerto Rico	Employment and Training Enterprises Corporation	Caribbean Basin Projects Financing Authority	Puerto Rico Conservatory of Music Corporation	Musical Arts Corporation	Corporation for the Development of the Arts, Sciences, and Film Industry
Current assets:							
Cash and cash equivalents in commercial banks	\$	457	149	—	119	3,617	10,687
Cash and cash equivalents in component unit banks		—	825	106	—	—	1,517
Investments, including collateral from securities lending transactions		—	—	—	—	—	—
Receivables, net:							
Insurance premiums		—	—	—	—	—	—
Intergovernmental		—	—	—	—	—	—
Accounts		726	1,306	—	—	59	—
Loans and advances		—	—	—	—	—	—
Accrued interest		—	—	—	—	—	—
Other governmental entities		—	—	—	284	485	—
Other		—	—	—	142	28	—
Due from:							
Primary government		—	—	—	11,885	—	—
Component units		6,913	—	—	—	—	—
Inventories		—	693	—	—	—	—
Prepaid expenses		1,056	—	—	14	24	—
Total current assets		9,152	2,973	106	12,444	4,213	12,204
Noncurrent assets:							
Restricted assets:							
Cash and cash equivalents in commercial banks		1,833	3,000	—	777	—	—
Cash and cash equivalents in component unit banks		—	788	—	—	—	—
Investments and other restricted assets		—	—	—	—	—	—
Investments		—	—	—	—	—	—
Receivables:							
Loans, interest and other		—	—	—	—	—	2,953
Other governmental entities		—	—	—	—	—	—
Due from:							
Primary government		—	—	—	—	—	—
Component units		—	—	—	—	—	—
Property held for sale or future development		—	—	—	—	—	—
Capital assets not being depreciated		—	—	—	16,857	153	—
Capital assets, depreciable, net		229	506	—	1,893	409	13
Deferred expenses and other assets		—	—	—	—	—	—
Total noncurrent assets		2,062	4,294	—	19,527	562	2,966
Total assets	\$	11,214	7,267	106	31,971	4,775	15,170

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005
(In thousands)

	Assets	Governing Board of the 9-1-1 Service	Institutional Trust of the National Guard of Puerto Rico	Special Communities Perpetual Trust	Puerto Rico Convention Center District Authority	Total
Current assets:						
Cash and cash equivalents in commercial banks	\$	—	—	—	21,470	188,418
Cash and cash equivalents in component unit banks		16,088	42,321	24,916	500	400,583
Investments, including collateral from securities lending transactions		—	646	—	—	1,490,872
Receivables, net:						
Insurance premiums		—	—	—	—	84,882
Intergovernmental		—	—	—	—	3,414
Accounts		3,119	—	—	2,146	166,347
Loans and advances		—	—	—	—	56,081
Accrued interest		44	—	105	—	33,269
Other governmental entities		255	—	—	1,898	46,722
Other		—	3,145	748	—	31,752
Due from:						
Primary government		—	—	—	—	49,195
Component units		—	—	—	1,000	30,137
Inventories		38	—	—	—	28,362
Prepaid expenses		—	—	—	976	11,795
Total current assets		19,544	46,112	25,769	27,990	2,621,829
Noncurrent assets:						
Restricted assets:						
Cash and cash equivalents in commercial banks		—	—	—	—	174,677
Cash and cash equivalents in component unit banks		10,883	3,000	656,037	—	872,743
Investments and other restricted assets		—	—	—	—	1,409,935
Investments		—	—	—	—	1,243,084
Receivables:						
Loans, interest and other		—	—	—	—	101,351
Other governmental entities		383	—	—	—	1,838
Due from:						
Primary government		—	—	—	—	—
Component units		—	—	—	—	40,544
Property held for sale or future development		—	—	—	1,887	145,967
Capital assets not being depreciated		—	1,483	—	379,053	1,350,858
Capital assets, depreciable, net		7,164	4,186	—	208,007	1,829,164
Deferred expenses and other assets		—	2,059	—	775	24,585
Total noncurrent assets		18,430	10,728	656,037	589,722	7,194,746
Total assets	\$	37,974	56,840	681,806	617,712	9,816,575

Nonmajor Discretely Presented Component Units – Statement of Net Assets

(In thousands)

(Continued)

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005

(In thousands)

Liabilities and Net Assets	Puerto Rico Land Administration	National Parks Company of Puerto Rico	Puerto Rico Medical Services Administration	Puerto Rico Trade and Export Company	Tourism Company of Puerto Rico	Cardiovascular Center Corporation of Puerto Rico and the Caribbean
Current liabilities:						
Accounts payable and accrued liabilities	\$ 2,244	8,177	60,796	8,270	36,546	23,708
Deposits and escrow liabilities	1,474	—	—	—	—	—
Due to:						
Primary government	—	—	13,428	—	10,730	37,899
Component units	—	6,831	32,361	488	—	—
Other governmental entities	—	1,183	5,600	—	—	—
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—
Interest payable	—	852	—	104	—	—
Deferred revenue	—	—	—	—	—	—
Notes payable, current portion	—	—	—	—	—	—
Commonwealth appropriation bonds, current portion	—	—	—	—	572	—
Bonds payable, current portion	—	236	—	—	1,799	1,986
Accrued compensated absences	—	—	8,185	—	—	—
Insurance benefit payable	—	—	—	—	—	—
Current portion of other long-term liabilities	—	—	4,557	—	107	324
Total current liabilities	3,718	17,279	124,927	8,862	49,754	63,917
Noncurrent liabilities:						
Due to:						
Primary government	—	—	—	—	—	—
Component units	—	—	—	8,231	—	—
Deferred revenue	—	—	—	—	—	—
Notes payable	—	—	—	—	—	—
Commonwealth appropriation bonds	—	—	—	—	126,346	—
Bonds payable	849	5,878	—	—	—	—
Accrued compensated absences	39,010	977	10,404	4,398	6,110	—
Other long-term liabilities	—	—	—	—	8,911	50,289
Total noncurrent liabilities	39,859	6,855	10,404	12,629	141,367	50,289
Total liabilities	43,577	24,134	135,331	21,491	191,121	114,206
Invested in capital assets, net of related debt	29,288	226,492	33,852	37,594	28,754	(24,966)
Restricted for:						
Trust-nonexpendable	—	—	—	—	—	—
Capital projects	—	—	—	—	—	2,880
Debt service	—	—	—	—	—	—
Student loans and other educational purposes	—	—	—	—	—	—
Other specified purposes	442	42,136	318	17,282	—	—
Unrestricted	195,751	(6,915)	(54,633)	70,157	(17,009)	(22,300)
Total net assets	225,481	261,713	(20,463)	125,033	11,745	(44,386)
Total liabilities and net assets	\$ 269,058	285,847	114,868	146,524	202,866	69,820

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005

(In thousands)

		Agricultural Services and Development Corporation	Puerto Rico Land Authority	Puerto Rico Metropolitan Bus Authority	Puerto Rico Telephone Authority	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental, Control Facilities Financing Authority	Puerto Rico Solid Waste Authority
Liabilities and Net Assets							
Current liabilities:							
Accounts payable and accrued liabilities	\$	164,722	70,490	24,577	280	269	13,861
Deposits and escrow liabilities		—	11,228	—	—	—	—
Due to:							
Primary government		—	—	—	—	—	—
Component units		17,413	43,270	3,153	—	1,000	28,500
Other governmental entities		13,147	114	—	—	—	—
Securities lending transactions and reverse repurchase agreements		—	—	—	—	—	—
Interest payable		—	5,030	276	—	—	—
Deferred revenue		571	—	534	—	—	—
Notes payable, current portion		—	2,121	—	—	—	—
Commonwealth appropriation bonds, current portion		—	718	—	—	—	—
Bonds payable, current portion		—	—	—	—	—	—
Accrued compensated absences		9,824	1,340	—	—	—	438
Insurance benefit payable		—	—	—	—	—	—
Current portion of other long-term liabilities		—	3,960	—	7,506	—	38
Total current liabilities		205,677	138,271	28,540	7,786	1,269	42,837
Noncurrent liabilities:							
Due to:							
Primary government		—	—	—	—	—	—
Component units		67,000	—	22,813	—	—	45,434
Deferred revenue		—	—	—	—	—	—
Notes payable		—	8,483	—	—	—	7,702
Commonwealth appropriation bonds		—	160,714	—	—	—	—
Bonds payable		—	—	—	—	—	—
Accrued compensated absences		—	—	—	—	—	531
Other long-term liabilities		661	—	—	—	—	45
Total noncurrent liabilities		67,661	169,197	22,813	—	—	53,712
Total liabilities		273,338	307,468	51,353	7,786	1,269	96,549
Invested in capital assets, net of related debt		—	91,272	63,395	—	—	107,183
Restricted for:							
Trust-nonexpendable		—	—	—	—	—	—
Capital projects		—	—	42	—	—	—
Debt service		—	—	—	—	—	—
Student loans and other educational purposes		—	—	—	—	—	—
Other specified purposes		—	(151,447)	—	10,513	—	2,166
Unrestricted		(89,554)	(89,830)	(36,225)	130	7,667	4,840
Total net assets		(89,554)	(150,005)	27,212	10,643	7,667	114,189
Total liabilities and net assets	\$	183,784	157,463	78,565	18,429	8,936	210,738

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005

(In thousands)

	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Right to Employment Administration	Puerto Rico Broadcasting Corporation	Fine Arts Center Corporation	Puerto Rico Maritime Transportation Authority	Puerto Rico Council on Higher Education
Liabilities and Net Assets						
Current liabilities:						
Accounts payable and accrued liabilities	\$ 7,871	1,455	2,594	537	19,154	735
Deposits and escrow liabilities	—	—	—	225	38	—
Due to:						
Primary government	—	—	—	—	—	—
Component units	—	—	—	—	—	—
Other governmental entities	—	760	—	3	—	—
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—
Interest payable	—	—	—	—	—	—
Deferred revenue	—	6,141	3,238	1,871	—	—
Notes payable, current portion	—	—	—	—	—	—
Commonwealth appropriation bonds, current portion	—	—	—	—	—	—
Bonds payable, current portion	—	—	—	—	—	—
Accrued compensated absences	1,034	1,302	865	58	1,121	53
Insurance benefit payable	—	—	—	—	—	—
Current portion of other long-term liabilities	—	—	—	76	—	—
Total current liabilities	8,905	9,658	6,697	2,770	20,313	788
Noncurrent liabilities:						
Due to:						
Primary government	—	—	—	—	—	—
Component units	—	—	—	—	27,090	—
Deferred revenue	—	—	—	—	—	—
Notes payable	—	—	—	—	—	—
Commonwealth appropriation bonds	—	—	—	—	—	—
Bonds payable	—	—	—	—	—	—
Accrued compensated absences	—	1,469	1,354	609	—	304
Other long-term liabilities	—	—	—	20	40	—
Total noncurrent liabilities	—	1,469	1,354	629	27,130	304
Total liabilities	8,905	11,127	8,051	3,399	47,443	1,092
Invested in capital assets, net of related debt	159	395	22,333	18,796	58,753	528
Restricted for:						
Trust-nonexpendable	—	—	—	—	—	—
Capital projects	—	—	—	1,212	—	—
Debt service	—	—	—	—	—	—
Student loans and other educational purposes	—	—	—	—	—	9,105
Other specified purposes	59,763	611	—	—	—	—
Unrestricted	53,609	(1,607)	(527)	(403)	(46,531)	410
Total net assets	113,531	(601)	21,806	19,605	12,222	10,043
Total liabilities and net assets	\$ 122,436	10,526	29,857	23,004	59,665	11,135

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005

(In thousands)

Liabilities and Net Assets

Current liabilities:									
Accounts payable and accrued liabilities	\$	1,958	4,123						257
Deposits and escrow liabilities		—	—					1,026	—
Due to:									
Primary government		—	—					—	—
Component units		6,431	662					—	—
Other governmental entities		—	—					—	—
Securities lending transactions and reverse repurchase agreements		—	—					—	—
Interest payable		—	23					—	—
Deferred revenue		722	—					1,568	—
Notes payable, current portion		—	—					—	—
Commonwealth appropriation bonds, current portion		—	—					—	—
Bonds payable, current portion		—	—					—	—
Accrued compensated absences		459	174					191	2
Insurance benefit payable		—	—					—	—
Current portion of other long-term liabilities		—	—					—	—
Total current liabilities		9,570	4,982					2,785	259
Noncurrent liabilities:									
Due to:									
Primary government		—	7,108					—	—
Component units		—	—					—	—
Deferred revenue		—	788					—	—
Notes payable		—	—					—	—
Commonwealth appropriation bonds		—	—					—	—
Bonds payable		—	—					—	—
Accrued compensated absences		—	—					64	58
Other long-term liabilities		—	—					2,481	—
Total noncurrent liabilities		—	7,896					2,545	58
Total liabilities		9,570	12,878					5,330	317
Invested in capital assets, net of related debt		229	506					562	13
Restricted for:									
Trust-nonexpendable		—	—					—	—
Capital projects		—	—					—	—
Debt service		—	—					—	—
Student loans and other educational purposes		—	—					—	—
Other specified purposes		1,833	—					—	—
Unrestricted		(418)	(6,117)					(1,117)	14,840
Total net assets		1,644	(5,611)					(555)	14,853
Total liabilities and net assets	\$	11,214	7,267					4,775	15,170

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Net Assets

June 30, 2005

(In thousands)

Liabilities and Net Assets	Governing Board of the 9-1-1 Service	Institutional Trust of the National Guard of Puerto Rico	Special Communities Perpetual Trust	Puerto Rico Convention Center District Authority	Total
Current liabilities:					
Accounts payable and accrued liabilities	\$ 3,238	1,496	38,673	26,769	789,673
Deposits and escrow liabilities	—	—	—	1,785	453,529
Due to:					
Primary government	5,034	—	—	—	67,091
Component units	—	—	75,107	434,402	667,108
Other governmental entities	—	—	—	7,441	28,248
Securities lending transactions and reverse repurchase agreements	—	—	—	—	256,650
Interest payable	—	—	7,990	6,948	61,432
Deferred revenue	—	—	—	1,232	107,138
Notes payable, current portion	—	—	—	—	34,359
Commonwealth appropriation bonds, current portion	—	—	—	—	1,290
Bonds payable, current portion	—	—	—	—	110,645
Accrued compensated absences	615	170	—	320	84,739
Insurance benefit payable	—	—	—	—	841,579
Current portion of other long-term liabilities	—	—	—	—	31,516
Total current liabilities	8,887	1,666	121,770	478,897	3,534,997
Noncurrent liabilities:					
Due to:					
Primary government	—	—	—	—	7,108
Component units	—	—	350,000	—	828,976
Deferred revenue	—	—	—	—	16,290
Notes payable	—	—	—	—	617,293
Commonwealth appropriation bonds	—	—	—	—	294,762
Bonds payable	—	—	—	—	1,507,133
Accrued compensated absences	—	—	—	—	19,929
Other long-term liabilities	—	—	—	—	226,054
Total noncurrent liabilities	—	—	350,000	—	3,517,545
Total liabilities	8,887	1,666	471,770	478,897	7,052,542
Invested in capital assets, net of related debt	7,164	5,669	—	139,452	1,567,717
Restricted for:					
Trust-nonexpendable	—	—	—	—	—
Capital projects	—	—	—	—	34,322
Debt service	—	—	—	—	196,407
Student loans and other educational purposes	—	500	—	—	10,375
Other specified purposes	10,883	2,500	—	—	9,860
Unrestricted	11,040	46,505	210,036	(637)	945,352
Total net assets	29,087	55,174	210,036	138,815	2,764,033
Total liabilities and net assets	\$ 37,974	\$ 56,840	\$ 681,806	\$ 617,712	\$ 9,816,575

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units – Statement of Activities

Year ended June 30, 2005

(In thousands)

Component units	Expenses	Program revenue			Net revenue (expenses) and changes in net assets	General revenue					Change in net assets	Net assets, beginning year as restated	Net assets, end of year
		Charges for services	Operating grants and contributions	Capital grants and contributions		Payments from primary government	Payments from other component units	Grants and contributions not restricted to specific programs	Taxes	Interest and investment earnings			
Agricultural Services and Development Administration	\$ 176,501	58,153	—	—	(118,348)	108,030	—	—	—	—	(21,035)	(68,519)	(89,554)
Automobile Accident Compensation Administration	99,035	79,481	—	—	(19,554)	—	—	—	—	12,842	(6,712)	58,901	52,189
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	67,710	58,832	—	—	(8,878)	5,000	—	—	—	67	(3,811)	(40,375)	(44,386)
Caribbean Basin Projects Financing Authority	4	—	—	—	(4)	—	—	—	—	4	—	103	103
Corporation for the Development of the Arts, Sciences, and Film Industry of Puerto Rico	1,260	72	—	—	(1,188)	1,870	—	—	3,139	—	106	10,926	14,853
Economic Development Bank for Puerto Rico	42,443	41,762	—	—	(681)	—	—	—	—	4,695	4,014	109,078	113,092
Employment and Training Enterprises Corporation	7,696	6,177	234	—	(1,285)	906	—	—	—	73	(235)	(5,376)	(5,611)
Farm Insurance Corporation of Puerto Rico	14,760	8,739	—	—	(6,021)	—	—	—	—	33	(5,246)	6,890	1,644
Fine Arts Center Corporation	6,983	2,350	—	—	(4,633)	4,173	—	—	—	118	(342)	19,947	19,605
Governing Board of the 9-1-1 Service Institutional Trust of the National Guard of Puerto Rico	16,110	20,221	—	—	4,111	—	—	—	—	513	25	24,438	29,087
Musical Arts Corporation	7,704	18,580	—	—	10,876	—	—	—	—	794	(5)	43,509	55,174
National Parks Company of Puerto Rico	9,946	932	979	—	(8,035)	6,218	—	—	411	753	(653)	98	261,713
National Parks Company for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	46,189	10,360	—	—	(35,829)	27,666	—	—	—	927	(6,978)	268,691	261,713
Puerto Rico Conservatory of Music Corporation	5,822	14,081	4,314	—	12,573	—	—	—	—	2,938	15,511	98,020	113,531
Puerto Rico Convention Center District Authority	7,468	2,469	378	—	(4,621)	11,344	—	—	—	5	6,728	23,028	29,756
Puerto Rico Council on Higher Education	21,853	12,268	—	—	(9,585)	3,017	78,670	—	8,003	184	7	58,519	138,815
Puerto Rico Trade and Export Company	32,998	85	2,190	—	(30,723)	30,837	—	—	—	170	361	9,682	10,043
Puerto Rico Industrial Development Company	27,333	15,327	—	—	(12,006)	19,771	—	—	—	846	48	116,374	125,033
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	100,929	58,142	—	1,037	(41,750)	19,254	—	—	—	5,110	15,391	465,766	467,056
Puerto Rico Land Administration	30,189	258	—	—	(29,931)	20,000	(78,670)	—	—	599	(88,002)	95,669	7,667
Puerto Rico Land Authority	22,595	24,396	—	—	1,801	1,586	—	—	—	3,423	6,963	218,518	225,481
Puerto Rico Maritime Transportation Authority	30,536	20,866	—	—	(9,670)	—	—	—	11,075	1,160	2,731	(152,736)	(150,005)
Puerto Rico Medical Services Administration	34,170	3,817	—	5,236	(25,117)	15,500	—	—	—	—	(9,617)	21,839	12,222
Puerto Rico Metropolitan Bus Authority	142,636	104,147	—	—	(38,489)	6,932	—	—	—	208	(31,349)	10,886	(20,463)
Puerto Rico Municipal Finance Agency	78,487	26,734	22,461	—	(29,292)	22,855	—	—	—	108	(6,329)	33,541	27,212
Puerto Rico Ports Authority	69,218	—	—	16,514	(69,218)	—	—	—	—	7,986	15	108,375	116,361
Puerto Rico Public Broadcasting Corporation	172,334	135,373	—	—	(20,447)	—	—	—	—	1,114	22,364	307,390	310,421
Puerto Rico Solid Waste Authority	30,674	1,408	—	—	(29,266)	27,702	2,803	—	—	127	1,916	19,890	21,806
Puerto Rico Telephone Authority	16,104	973	—	—	(15,131)	7,297	—	—	—	569	(7,265)	121,454	114,189
Right to Employment Administration	13,948	—	—	—	(13,948)	—	—	—	—	144	(13,804)	24,447	10,643
Special Communities Perpetual Trust	70,486	—	2,670	—	(67,816)	65,626	—	—	—	89	(2,022)	1,421	(601)
State Insurance Fund Corporation	244,241	—	—	—	(244,241)	25,000	500,000	—	—	9,672	29,362	(81,326)	210,036
Tourism Company of Puerto Rico	590,537	686,628	—	—	(96,091)	7,850	—	—	37,928	82,986	179,077	396,634	573,731
	317,438	290,403	—	—	(27,035)	—	—	—	—	3,622	22,868	(11,123)	11,745
Total nonmajor component units	\$ 2,556,337	\$ 1,703,034	\$ 33,226	\$ 22,787	\$ (797,290)	\$ 438,434	\$ 500,000	\$ 2,803	\$ 60,556	\$ 210,329	\$ 15,563	\$ 2,314,399	\$ 2,764,033

STATISTICAL SECTION

STATISTICAL SECTION

This part of the Commonwealth of Puerto Rico's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Commonwealth's overall financial health.

Contents	Page
Financial Trends	1 – 4
These schedules contain trend information to help the reader understand how the Commonwealth's financial performance and well-being have changed over time.	
Revenue Capacity	5
This schedule contains information to help the reader assess the Commonwealth's most significant local revenue sources.	
Debt Capacity	6 – 7
These schedules present information to help the reader assess the affordability of the Commonwealth's current levels of outstanding debt and the Commonwealth's ability to issue additional debt in the future.	
Demographic And Economic Information	8 – 10
These schedules offer demographic and economic indicators to help the reader understand the environment within which the Commonwealth's financial activities take place.	
Operating Information	11
This schedule contains service data to help the reader understand how the information in the Commonwealth's financial report relates to the services the government provides and the activities it performs.	

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial reports for the relevant year.

COMMONWEALTH OF PUERTO RICO

Changes in Net Assets
For the last four fiscal years

Accrual Basis of Accounting
(In thousands)

	2005	2004	2003	2002
Expenses:				
Governmental activities:				
General government	\$ 1,827,816	1,963,879	2,324,715	1,429,265
Public safety	2,580,951	1,950,635	1,606,272	1,883,061
Health	2,364,110	2,386,735	1,903,811	1,990,852
Public housing and welfare	3,443,886	2,919,315	3,239,366	2,803,742
Education	5,000,686	3,684,331	3,375,815	3,477,373
Economic development	1,006,945	896,925	451,945	632,083
Intergovernmental	—	591,237	466,762	467,957
Interest and other	845,556	778,700	671,228	646,120
Total governmental activities	17,069,950	15,171,757	14,039,914	13,330,453
Business-type activities:				
Lotteries	699,407	731,344	695,888	603,768
Unemployment	197,967	142,652	343,243	331,754
Other	32,437	26,763	22,385	16,902
Total business-type activities	929,811	900,759	1,061,516	952,424
Total primary government expenses	17,999,761	16,072,516	15,101,430	14,282,877
Program revenue:				
Governmental activities:				
Charges for services	702,691	769,207	757,116	535,423
Operating grants and contributions	4,096,204	3,462,924	3,830,639	3,400,729
Capital grants and contributions	121,083	167,907	173,644	187,512
Total governmental activities	4,919,978	4,400,038	4,761,399	4,123,664
Business activities:				
Charges for services	1,187,009	1,136,705	1,132,285	1,021,070
Operating grants and contributions	22,315	59,728	97,033	26,509
Total business-type activities	1,209,324	1,196,433	1,229,318	1,047,579
Net (expense) revenue:				
Governmental activities	(12,149,972)	(10,771,719)	(9,278,515)	(9,206,789)
Business-type activities	279,513	295,674	167,802	95,155
Total primary government net expense	(11,870,459)	(10,476,045)	(9,110,713)	(9,111,634)
General revenue:				
Governmental activities:				
Taxes:				
Income	5,526,006	5,191,080	4,941,128	4,446,570
Excise	2,101,216	1,924,610	1,894,729	1,713,098
Other	7,128	19,211	3,055	1,963
Revenue from global settlement agreement	106,521	70,420	101,849	37,153
Unrestricted investment earnings	116,686	60,585	85,565	90,940
Revenue from component units	474,069	175,729	111,752	228,118
Grants and contributions not restricted to specific programs	228,990	127,521	226,089	148,671
Payment from agency fund	—	—	—	129,000
Special item	—	(35,646)	(203,514)	123,785
Transfers	492,776	203,258	279,060	187,183
Other	195,886	262,904	91,715	472,642
Total governmental activities	9,249,278	7,999,672	7,531,428	7,579,123
Business-type activities:				
Unrestricted investments earnings	32,284	23,831	77,362	36,455
Revenue from component units	—	—	1,038	3,370
Grants and contributions not restricted to specific programs	—	—	—	44,320
Transfers	(492,776)	(203,258)	(279,060)	(187,183)
Total business-type activities	(460,492)	(179,427)	(200,660)	(103,038)
Total primary government	8,788,786	7,820,245	7,330,768	7,476,085
Change in net assets:				
Governmental activities	(2,900,694)	(2,772,047)	(1,747,087)	(1,627,666)
Business-type activities	(180,979)	116,247	(32,858)	(7,883)
Total primary government	\$ (3,081,673)	(2,655,800)	(1,779,945)	(1,635,549)

COMMONWEALTH OF PUERTO RICO

Net Assets by Component
For the last four fiscal years

Accrual Basis of Accounting
(In thousands)

	2005	2004	2003	2002
Governmental activities:				
Invested in capital assets, net of related debt	\$ 3,623,158	3,133,230	1,969,864	1,909,137
Restricted	296,692	—	19,749	4,616
Unrestricted (deficit)	<u>(19,836,639)</u>	<u>(16,789,576)</u>	<u>(13,942,397)</u>	<u>(12,085,385)</u>
Total governmental activities net assets	<u>\$ (15,916,789)</u>	<u>(13,656,346)</u>	<u>(11,952,784)</u>	<u>(10,171,632)</u>
Business-type activities:				
Invested in capital assets, net of related debt	\$ 847	1,672	1,895	310
Restricted	872,215	853,194	736,947	769,804
Unrestricted (deficit)	<u>(202,212)</u>	<u>(3,037)</u>	<u>(3,260)</u>	<u>(1,675)</u>
Total business-type activities net assets	<u>\$ 670,850</u>	<u>851,829</u>	<u>735,582</u>	<u>768,439</u>
Primary government:				
Invested in capital assets, net of related debt	\$ 3,624,005	3,134,902	1,971,759	1,909,447
Restricted	1,168,907	853,194	756,696	774,420
Unrestricted (deficit)	<u>(20,038,851)</u>	<u>(16,792,613)</u>	<u>(13,945,657)</u>	<u>(12,087,060)</u>
Total primary government net assets	<u>\$ (15,245,939)</u>	<u>(12,804,517)</u>	<u>(11,217,202)</u>	<u>(9,403,193)</u>

COMMONWEALTH OF PUERTO RICO
Changes in Fund Balances of Governmental Funds
All Governmental Fund Types

For the last ten fiscal years
(In thousands)

	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Revenues										
Taxes:										
Income	5,564,672	5,061,761	4,874,795	4,843,852	4,536,840	4,967,138	4,413,860	3,989,239	3,622,988	3,396,724
Excise	2,101,216	1,924,610	1,894,729	1,713,098	1,788,992	1,736,539	1,714,444	1,884,348	1,827,305	1,713,537
Other	8,752	19,211	3,055	1,963	92,024	87,523	78,926	73,426	64,910	57,662
Charges for services	702,691	750,978	780,905	535,423	645,806	617,020	457,454	569,096	464,034	461,736
Intergovernmental	4,446,276	3,776,579	4,230,372	3,736,912	3,807,049	2,971,528	3,417,647	3,009,169	3,077,042	2,545,615
Interest	116,686	58,914	85,565	90,940	67,020	91,525	97,880	116,030	110,777	59,788
Other	741,416	507,613	314,002	736,686	270,711	383,548	162,228	189,476	134,819	186,591
Total revenue - all governmental fund types	13,681,709	12,099,666	12,183,423	11,658,874	11,208,442	10,854,821	10,342,439	9,830,784	9,301,875	8,421,653
Expenditures:										
General government	1,675,428	1,777,365	1,774,156	1,279,750	739,009	853,040	526,629	484,547	499,652	661,359
Public safety	2,409,668	1,765,199	1,424,846	1,659,280	1,623,362	1,310,322	1,103,606	1,241,762	1,188,814	926,498
Health	2,344,522	2,176,741	1,908,717	1,983,717	954,563	972,757	625,475	656,498	508,659	245,743
Public housing and welfare	3,320,849	2,738,016	2,953,189	2,726,129	2,315,899	2,102,410	2,485,092	1,902,902	2,086,828	1,701,434
Education	4,177,664	3,474,013	3,297,248	3,343,002	2,308,479	2,436,267	2,272,903	2,744,630	1,960,185	1,832,271
Economic development	706,066	868,926	428,621	637,794	170,937	337,255	314,897	186,296	333,290	88,143
Intergovernmental	—	528,829	465,699	466,169	222,721	373,016	318,664	55,739	496,844	306,226
Capital outlays	665,630	581,788	1,184,976	507,634	1,020,344	833,597	642,016	1,515,230	1,395,463	1,255,430
Debt service:										
Principal	391,554	526,572	330,346	2,062,059	466,467	416,369	351,722	620,866	359,851	367,198
Interest and other	733,931	737,502	1,138,749	614,347	545,001	444,595	442,614	595,053	556,835	504,480
Total expenditures - all governmental fund types	16,425,312	15,174,951	14,926,547	15,279,891	10,366,782	10,079,628	9,083,618	10,003,523	9,386,421	7,888,782
Other Financing Sources (Uses)										
Transfers in	1,745,992	1,034,090	1,664,278	966,935	756,229	1,026,581	992,667	1,116,455	1,255,621	903,848
Transfers out	(1,253,216)	(830,832)	(1,385,218)	(779,752)	(2,864,056)	(2,646,732)	(2,841,330)	(2,156,852)	(2,330,765)	(2,453,364)
Long-term debt issued	1,619,562	3,001,116	2,241,190	3,107,821	834,396	474,471	479,610	1,971,960	1,258,495	1,412,620
Discount on bonds issued	(6,078)	(23,061)	(36,204)	(16,075)	—	—	—	—	—	—
Capital leases	847	2,300	58,897	—	—	—	—	—	—	—
Refunding bonds issued	—	2,372,689	1,754,686	1,636,838	329,370	54,645	117,529	631,906	335,155	308,243
Payment to refunded bond escrow agent	—	(2,316,910)	(1,754,686)	(1,665,811)	(227,369)	(54,645)	(117,529)	(632,822)	(333,111)	(251,822)
Other	—	—	—	327,785	—	—	—	140,000	—	—
Total other financing sources (uses) - all government fund types	2,107,107	3,239,392	2,542,943	3,577,741	(1,171,430)	(1,145,680)	(1,369,053)	1,070,647	185,395	(80,475)
Net Change in Fund Balances (Deficit)	\$ (636,496)	164,107	(200,181)	(43,276)	(329,770)	(370,487)	(110,232)	897,908	100,849	452,396

In 2002, the Commonwealth adopted GASB No. 34. This statement requires to component units to be included as expenditure by function. In prior years such payments were reported as operating transfers-out to component units.

COMMONWEALTH OF PUERTO RICO

Fund Balances of Governmental Funds
For the last four fiscal years

Modified Accrual Basis of Accounting
(In thousands)

	2005	2004	2003	2002
General fund:				
Reserved	\$ 822,542	1,102,232	262,758	366,558
Unreserved (deficit)	<u>(1,333,813)</u>	<u>(1,468,182)</u>	<u>(342,941)</u>	<u>(193,131)</u>
Total general fund	\$ <u>(511,271)</u>	<u>(365,950)</u>	<u>(80,183)</u>	<u>173,427</u>
All other governmental funds:				
Reserved	\$ 45,546	72,455	33,047	72,455
Unreserved reported in:				
Debt service funds	156,565	119,830	168,928	120,216
Special revenue funds	256,949	449,455	506,252	378,852
Capital project funds	437,922	744,577	228,215	356,201
Total all other governmental funds	<u>896,982</u>	<u>1,386,317</u>	<u>936,442</u>	<u>927,724</u>

COMMONWEALTH OF PUERTO RICO

General Fund Net Revenue
For the last ten fiscal years
(In thousands)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total	\$ 5,247,616	\$ 5,600,748	\$ 5,902,506	\$ 6,550,043	\$ 6,894,525	\$ 6,962,134	\$ 7,454,399	\$ 7,841,742	\$ 7,985,388	\$ 8,305,669
From internal revenue	\$ 4,974,918	\$ 5,335,879	\$ 5,630,040	\$ 6,271,392	\$ 6,598,544	\$ 6,632,090	\$ 6,865,454	\$ 7,505,866	\$ 7,622,201	\$ 7,937,772
Tax revenue	\$ 4,729,320	\$ 5,095,218	\$ 5,358,805	\$ 5,982,504	\$ 6,295,310	\$ 6,204,639	\$ 6,428,083	\$ 6,910,345	\$ 7,091,198	\$ 7,374,589
Property taxes	5,107	8,286	5,673	2,214	1,131	287	—	—	—	3,949
Income taxes, total	\$ 3,368,175	\$ 3,610,016	\$ 3,972,869	\$ 4,433,804	\$ 4,856,011	\$ 4,778,590	\$ 4,878,418	\$ 5,170,294	\$ 5,297,931	\$ 5,485,950
Individuals	1,709,116	1,825,337	2,026,612	2,244,376	2,352,066	2,259,090	2,449,982	2,767,678	2,720,920	2,885,903
Corporations	1,348,160	1,440,691	1,527,415	1,653,762	1,781,862	1,696,766	1,706,137	1,776,985	1,831,027	1,870,937
Partnerships	3,323	2,120	4,004	2,087	2,339	3,026	2,670	2,101	3,005	3,245
Withholding to nonresidents	78,235	88,603	192,463	369,384	557,276	696,835	583,256	517,141	631,100	612,005
Tollgate tax (regular)	78,554	83,640	65,285	49,284	57,203	23,664	44,213	35,576	24,411	17,611
Tollgate tax (prepayment)	100,900	126,605	105,668	65,284	53,927	25,847	15,302	9,745	7,168	5,362
Interest subject 17 %	6,662	7,582	11,406	10,666	11,674	14,782	14,310	11,278	10,108	10,489
Taxes on dividends	43,225	35,438	39,616	38,996	39,664	58,580	62,548	49,790	70,192	80,398
Inheritance and gift taxes	1,547	4,028	1,380	1,811	3,109	7,475	1,962	2,825	15,691	7,129
Excise taxes, total	\$ 1,304,024	\$ 1,419,353	\$ 1,312,716	\$ 1,473,827	\$ 1,410,346	\$ 1,341,949	\$ 1,465,128	\$ 1,651,350	\$ 1,693,345	\$ 1,792,345
Alcoholic beverages, total	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Distilled spirits	54,934	51,855	48,034	47,519	49,425	46,963	51,734	58,389	61,306	56,641
Beer	172,425	167,321	178,465	181,348	170,065	177,448	170,737	223,309	217,568	221,902
Other beverages	10,556	9,867	11,619	14,597	16,884	13,101	18,234	17,884	17,428	19,692
General taxes, total	\$ 1,066,109	\$ 1,190,310	\$ 1,074,598	\$ 1,230,363	\$ 1,173,972	\$ 1,104,437	\$ 1,215,423	\$ 1,351,768	\$ 1,397,043	\$ 1,494,110
Cigarettes	107,177	120,287	111,094	119,105	115,157	119,135	116,055	149,487	144,733	146,527
Petroleum products	20,006	22,095	6,172	5,562	4,689	7,046	5,095	5,860	4,934	5,143
Motor vehicle	307,931	365,820	350,004	411,573	389,995	406,252	418,024	499,252	551,181	606,662
Horse races	29,535	29,138	27,401	21,405	26,351	18,893	22,033	28,872	28,865	31,463
Insurance premiums	20,748	19,430	19,364	20,368	21,564	22,845	22,290	26,771	27,217	28,324
Cement	1,901	2,234	1,702	2,417	2,531	2,707	3,426	3,279	3,432	3,228
Slot machines	—	—	12,230	26,330	30,869	—	36,953	90,018	76,966	85,513
Crude oil and derived products	157,742	158,739	51,636	70,056	24,786	1,901	38,619	12,925	—	—
5% general excise tax	396,689	446,500	468,425	520,351	525,561	508,972	486,302	505,709	535,381	557,323
Hotel rooms	11,237	12,139	13,299	15,923	17,275	—	—	9,056	—	—
Others	13,143	13,928	13,271	17,273	15,194	16,686	64,626	20,539	24,334	29,927
Licenses	50,467	53,535	66,167	70,848	24,713	76,338	82,575	85,876	84,231	85,216
Motor vehicles	39,667	42,354	46,268	46,781	45	49,834	54,896	58,426	55,638	55,669
Entertainment machines and others	—	—	7,327	9,235	10,545	11,522	12,874	13,932	14,593	15,019
Alcoholic beverages and others	—	—	—	—	—	—	—	—	—	—
Non-tax revenue	\$ 245,598	\$ 240,661	\$ 271,235	\$ 288,888	\$ 303,234	\$ 427,451	\$ 437,371	\$ 595,521	\$ 531,003	\$ 563,183
Traditional lottery	60,856	52,829	57,986	59,206	63,779	57,482	61,358	67,621	65,387	64,638
Electronic lottery	57,008	47,994	54,681	53,013	70,209	70,211	57,897	89,443	86,115	68,011
Transfer in from non-budgeted funds	—	—	—	—	—	—	—	—	—	—
Miscellaneous	127,734	139,838	158,568	176,669	169,246	89,093	80,000	123,600	379,501	430,534
From non-internal revenue	\$ 272,698	\$ 264,869	\$ 272,466	\$ 278,651	\$ 295,981	\$ 330,044	\$ 344,848	\$ 335,876	\$ 363,187	\$ 367,897
Custom duties	77,781	61,114	72,206	61,355	50,231	43,154	30,595	25,918	34,266	26,731
Excises on off-shore shipments	194,917	203,755	200,260	217,296	245,750	286,890	314,253	309,958	328,921	341,166
Administrative measures	—	—	—	—	—	—	244,097	—	—	—

Note : The net revenue presented above include the actual revenue and the operating transfers-in from other funds presented in the combined statement of revenue and expenditures – budget and actual – budget basis.
Source: Department of the Treasury of the Commonwealth

COMMONWEALTH OF PUERTO RICO

Legal Debt Margin Information
For the last ten fiscal years
(In thousands)

	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Internal revenue average for two years	\$ 7,779,987	7,564,034	7,185,660	6,748,772	6,639,861	6,459,512	5,950,716	5,482,960	5,155,399	4,877,705
Legal debt limit - 15% of internal revenue average for two years	1,166,998	1,134,605	1,077,849	1,012,316	995,979	968,927	892,607	822,444	773,310	731,656
Maximum debt service requirement	630,685	598,547	599,611	521,035	588,359	561,918	532,324	533,241	479,017	426,361
Additional legal debt service requirement margin	\$ 536,313	536,058	478,238	491,281	407,620	407,009	360,283	289,203	294,293	305,295
Total maximum debt service requirement as a percentage of internal revenue average for two years	8.11%	7.91%	8.34%	7.72%	8.86%	8.70%	8.95%	9.73%	9.29%	8.74%

Legal Debt Margin Calculation for Fiscal Year 2005	
Internal revenue for the year ended June 30, 2004	\$ 7,622,201
Internal revenue for the year ended June 30, 2005	7,937,772
Total internal revenue for the years ended June 30, 2004 and 2005	\$ 15,559,973
Internal revenue average for the two years	7,779,987
Legal debt limit - 15% of internal revenue average for the two years	1,166,998
Maximum debt service requirement	630,685
Additional legal debt service requirement margin	\$ 536,313
Total maximum debt service requirement as a percentage of internal revenue average for two years	8.11%

Source: Government Development Bank for Puerto Rico
General obligation debt service may not exceed 15% of the average of the internal revenues for the last two fiscal years.

COMMONWEALTH OF PUERTO RICO

Ratio of Annual Debt Service for General Bonded Debt to Total General Expenditures

For the last ten fiscal years
(In thousands)

Fiscal Year	Total Debt Service		General Governmental Expenditures		Ratio (%)
2005	\$	491,394	\$	16,425,312	3.0%
2004		459,336		15,174,951	3.0
2003		362,136		14,926,547	2.4
2002		608,674		15,279,891	4.0
2001		538,436		10,366,782	5.2
2000		507,336		10,079,628	5.0
1999		468,970		9,083,618	5.2
1998		435,894		10,003,523	4.4
1997		430,153		9,386,421	4.6
1996		424,753		7,888,782	5.4

COMMONWEALTH OF PUERTO RICO

Demographic and Economic Statistics

For the last ten fiscal years

Fiscal year	Population *	Per capita income	Median age	Life expectancy	School enrollment	Labor force*	Unemployment rate (%)	Gross product (current prices)**	Real gross product (2000 prices)**
2005	3,911	\$ 12,549	33.8	76.8	863,288	1,385	10.6	53,339	44,962
2004	3,895	12,031	33.8	76.8	864,597	1,360	11.4	50,320	43,937
2003	3,878	11,566	33.3	76.8	875,831	1,352	12.1	47,439	42,756
2002	3,860	10,921	32.9	75.2	792,284	1,309	12.0	45,071	41,909
2001	3,839	10,732	32.6	74.0	735,448	1,278	10.5	44,046	42,044
2000	3,816	10,204	32.2	74.0	750,026	1,292	11.0	41,419	41,419
1999	3,791	9,659	31.8	75.0	753,705	1,306	12.5	38,281	40,225
1998	3,770	9,108	31.4	73.0	753,431	1,318	13.6	35,111	38,658
1997	3,742	8,729	31.0	73.5	765,767	1,298	13.1	32,343	37,445
1996	3,704	8,076	30.7	73.0	770,537	1,268	13.8	30,357	36,209

Source: Puerto Rico Planning Board, Department of Education, Department of Labor and Human Resources, and the General Council of Education of the Commonwealth. The enrollment in private schools is an estimate.

* amounts expressed in thousands

** amounts expressed in millions

COMMONWEALTH OF PUERTO RICO

Average Employment by Sector

For the last ten fiscal years
(In thousands)

Sector	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Agriculture	26	25	24	23	21	24	27	31	31	32
Manufacturing	138	136	134	137	157	158	159	161	162	167
Construction	87	88	82	84	84	84	78	69	64	59
Trade	262	253	252	236	239	237	228	236	228	218
Finance, insurance, and real estates	43	42	42	42	39	42	42	40	37	39
Transportation, communications, and public utilities	59	54	55	61	55	54	58	59	59	61
Services	349	340	328	311	298	304	306	297	285	270
Government*	274	268	269	257	248	247	245	245	261	247
Total	1,238	1,206	1,186	1,151	1,141	1,150	1,143	1,138	1,127	1,093

*Includes the Commonwealth, its municipalities and federal government, and excludes public corporations.

Sources: Puerto Rico Department of Labor and Human Resources, Household Survey

COMMONWEALTH OF PUERTO RICO

Tourism Indicators

For the last ten fiscal years

	2005 (p)	2004	2003	2002	2001	2000	1999	1998	1997	1996
All hotels and hostelry registration	2,088,768	2,008,730	1,964,963	1,821,274	1,836,377	1,674,092	1,637,620	1,570,683	1,461,567	1,400,815
Occupancy rates	67.7%	68.9%	64.9%	67.8%	66.7%	70.7%	71.9%	67.3%	69.8%	69.0%
Numbers of rooms	13,459	12,864	12,778	12,768	12,353	11,928	11,102	11,848	10,869	10,265
Visitors expenditures*	\$ 3,245	3,024	2,677	2,486	2,728	2,388	2,139	2,233	2,046	1,898

*Amounts expressed in millions of dollars

(p) preliminary

Sources: Puerto Rico Tourism Company and Puerto Rico Planning Board

COMMONWEALTH OF PUERTO RICO

Operating Indicators by Function

For the last ten fiscal years

	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Fire Protection:										
Number of stations	94	98	93	93	92	96	92	91	91	91
Fire personnel and officers	2,233	1,851	1,894	1,857	1,852	1,818	2,004	2,004	1,791	1,488
Calls answered	11,514	10,716	12,340	13,256	14,271	31,681	28,575	23,299	37,698	31,879
Building inspections conducted	71,610	56,093	53,750	41,415	31,693	44,396	14,621	30,139	32,402	31,589
Police Protection:										
Number of stations	234	231	228	235	239	238	236	234	448	448
Police personnel and officers	20,806	21,185	21,079	20,468	20,800	20,822	20,305	19,934	17,650	18,150
Calls answered	7,178	6,907	5,538	4,673	4,957	5,059	4,545	4,748	5,000	5,367
Water system:										
Customers	1,251,699	1,256,981	1,238,461	1,209,834	1,195,038	1,179,109	1,163,673	1,148,284	1,141,648	1,110,363
Water consumption (millions of cubic meter)	356	359	350	349	348	350	348	343	364	355
Electric distribution system:										
Customers	1,438,699	1,419,602	1,401,301	1,383,888	1,365,668	1,344,907	1,326,055	1,309,954	1,291,633	1,268,948
Electricity consumption (millions of kilowatt)	20,507	20,260	19,887	19,130	18,723	18,144	16,989	17,457	16,118	15,945
Electricity production (millions of kilowatt)	24,500	24,100	23,717	22,514	22,132	21,461	20,140	20,725	19,143	18,883
Education:										
Enrollment in public schools										
Kindergarten to sixth grade	323,270	321,653	326,606	334,929	341,467	341,470	350,714	354,098	354,226	355,265
Seventh to ninth grade	137,717	142,305	146,896	146,837	145,858	145,908	144,157	143,382	145,591	150,287
Tenth to twelfth grade	118,491	116,829	118,519	117,072	119,162	118,498	114,684	111,798	117,340	116,981
Enrollment in private schools:										
Kindergarten to sixth grade	172,479	172,479	172,479	119,648	79,764	91,997	91,997	91,997	91,284	90,985
Seventh to ninth grade	62,574	62,574	62,574	41,256	27,503	28,448	28,448	28,448	31,244	31,072
Tenth to twelfth grade	48,757	48,757	48,757	32,542	21,694	23,705	23,705	23,708	26,082	25,947
Enrollment in universities and colleges:										
Public	71,044	74,056	74,801	73,974	73,846	73,846	72,010	70,765	68,838	66,511
Private	136,650	132,735	125,041	117,578	100,704	100,704	103,623	101,020	106,552	105,337

Source: Various agencies and component units of the Commonwealth. The enrollment in private schools is an estimate.